TAX YEAR
2025

Business Entity Comparison Chart

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Entity	Accounting and Recordkeeping	Fringe Benefits	Liability
Sole proprietor, single-member LLC, and spouses-owned business • Schedule C (Form 1040), *Profit or Loss From Business* • Schedule F (Form 1040), *Profit or Loss From Farming* • Schedule SE (Form 1040), *Self-Employment Tax* • IRS Pub. 334, *Tax Guide for Small Business*	• Accounting is less involved than partnerships and corporations. Double-entry bookkeeping is not required as no balance sheet is needed when filing Schedule C or Schedule F. • A non-LLC business owned solely by two spouses may elect not be taxed as a partnership and may file as two sole proprietorships to minimize bookkeeping requirements. • Cannot file as a fiscal year business unless owner files Form 1040 under the fiscal year rules.	Excludable fringe benefits are generally not allowed for the owner. ***Exceptions:*** Health insurance is deductible if the spouse is an employee of the sole proprietorship, and the owner is covered as a family member of the employee-spouse. Owners are eligible for dependent care assistance fringe benefits, de minimis fringe benefits, and working condition fringe benefits.	Owner is personally liable for all debts and lawsuits against the business. ***Exception:*** If organized as an LLC, liability is usually limited to owner's investment and his or her own malpractice or debt guarantees.
Partnership • Form 1065, *U.S. Return of Partnership Income* • IRS Pub. 541, *Partnerships* • IRS Pub. 3402, *Taxation of Limited Liability Companies* • IRC Subchapter K, §701 through §761	• Small partnerships are not required to provide a balance sheet and can use the same bookkeeping system as a sole proprietor. Larger partnerships must provide a balance sheet with the return, which requires double-entry bookkeeping. • A partnership must generally use the same tax year as its partners, but can use a fiscal year if there is a business purpose or an IRC section 444 election was made. • Complex books and records are needed when a partner exchanges property, other than cash, for a partnership interest or for special allocations and basis elections.	Partners are eligible for some excludable fringe benefits. Taxable benefits are reported as guaranteed payments or an adjustment to a partner's distributable share of profits.	A general partner is personally liable for all debts and lawsuits brought against the partnership. ***Exception:*** If the partner is a limited partner, or the business is organized as an LLC, liability is generally limited to the partner's investment, plus his or her own malpractice or debt guarantees.
S corporation • Form 1120-S, *U.S. Income Tax Return for an S Corporation* • IRC Subchapter S, §1361 through §1379	• Double-entry bookkeeping may be required depending on income and other factors affecting the need for a balance sheet on the return. • Must use a calendar year unless it establishes a business purpose for using a fiscal year, or it makes an IRC section 444 election.	Shareholder/employees are eligible for some excludable fringe benefits. Benefits added to taxable wages on Form W-2 of more than 2% shareholders include accident and health plans, up to $50,000 of group health insurance, and meals and lodging furnished for the employer's convenience.	A shareholder's liability is limited to the amount invested, plus his or her own malpractice or debt guarantees.
C corporation • Form 1120, *U.S. Corporation Income Tax Return* • IRS Pub. 542, *Corporations* • IRC Subchapter C, §301 through §385	• Double-entry bookkeeping may be required if the tax return requires a balance sheet. • No restriction on use of a fiscal year. ***Exception:*** A personal service corporation (PSC) must use a calendar year unless it establishes a business purpose for using a fiscal year or makes an IRC section 444 election. • Required to use accrual method of accounting if average annual gross receipts exceed $31 million.	Shareholder/employees eligible for excludable fringe benefits, generally to the same extent as any other employee, with exceptions under the nondiscrimination rules. Benefits can include health insurance and reimbursement, education, life insurance, etc.	A shareholder's liability is limited to the amount invested, plus his or her own malpractice or debt guarantees.

Business Entity Comparison Chart

Entity	Organization and Ownership	Taxation of Profits and Losses
Sole proprietor, single-member LLC, and spouses-owned business • Schedule C (Form 1040), *Profit or Loss From Business* • Schedule F (Form 1040), *Profit or Loss From Farming* • Schedule SE (Form 1040), *Self-Employment Tax* • IRS Pub. 334, *Tax Guide for Small Business*	• One individual carrying on an unincorporated trade or business. • A qualified joint venture whose only members are spouses may elect not to be taxed as a partnership and file as two sole proprietorships. An LLC may not make this election (except in community property states). • Easiest business to organize with minimal legal restrictions. • The entity does not exist apart from the owner. Business starts and ends based on the owner's involvement. • The owner has complete freedom over business decisions and is entitled to 100% of the profits. The owner is limited by his or her own ability to raise capital and obtain financing. Outside investors cannot be part owners. • Transfer of ownership consists of selling the business assets. • A single-member LLC is taxed as a sole proprietorship unless the election is made to be taxed as a corporation.	• The owner is self-employed and pays self-employment (SE) tax on net profits. • Net profits are subject to income tax in the year earned and cannot be deferred by retaining profits. • Losses offset other income in year incurred, such as Form W-2 wages, interest, dividends, and capital gains. ***Exceptions:*** Losses cannot be used to offset income from activities subject to passive loss, at-risk loss, and hobby loss rules. • Owner may qualify for the 20% qualified business income deduction (QBID).
Partnership • Form 1065, *U.S. Return of Partnership Income* • IRS Pub. 541, *Partnerships* • IRS Pub. 3402, *Taxation of Limited Liability Companies* • IRC Subchapter K, §701 through §761	• Two or more owners conducting an unincorporated trade or business. • Easy to organize with minimal legal restrictions. • Multi-member LLCs are taxed as partnerships, unless the election to be taxed as a corporation is made. • No limitations on the number of partners or partner entities. • More flexibility than a corporation in dividing up profits, losses, ownership of capital, and making special allocations to partners. • Contributing property in exchange for a partnership interest is a tax-free event (except for the receipt of cash). • Liquidating a partnership interest in exchange for property is generally tax-free, unless the liquidation is in cash only. • Getting out of a partnership may be more complicated than starting one. A partnership agreement can restrict selling or transferring of a partnership interest. • State law may limit an LLC's life.	• The partnership pays no income tax. Profits pass through to partners for individual payment of tax. • Tax to partners cannot be deferred by retaining business earnings. • Pass-through items retain the same character to the partner as they had to the partnership. • A general partner's distributive share of profits is subject to self-employment (SE) tax. Limited partners' share of profits not subject to SE tax unless in the form of guaranteed payments. • Payment for partner services to the partnership is not Form W-2 income, but may be guaranteed payments, profits, or special allocations. • Losses flow through to partners and can be used to offset other income such as Form W-2 wages, interest, dividends, and capital gains. ***Exceptions:*** Losses cannot be used to offset income from activities subject to passive loss, at-risk loss, and hobby loss rules. • Partner may qualify for the 20% qualified business income deduction (QBID).
S corporation • Form 1120-S, *U.S. Income Tax Return for an S Corporation* • IRC Subchapter S, §1361 through §1379	• A corporation that has elected to be taxed as an S corporation by filing Form 2553, *Election by a Small Business Corporation.* • Ownership is through owning shares of stock. Limited to 100 shareholders. (Spouses and their estates and all members of a family, as defined in IRC section 1361(c)(1)(B), and their estates can be treated as one shareholder for this test.) • Stock is limited to one class of stock with equal rights to distributions and liquidation proceeds. • Shareholders are limited to individuals, estates, certain trusts, and certain charities. Corporations and certain partnerships are ineligible to own stock. • Other ownership and organization issues are the same as a C corporation.	• An S corporation generally pays no tax. Profits flow through to the shareholders. • Pass-through items retain the same character to the shareholder as they had to the corporation. • Distributions are not subject to self-employment tax. • Shareholders who perform services are paid as employees and income is reported on Form W-2. • Losses flow through to shareholders and may be used to offset other income, subject to passive, at-risk, and hobby loss exception rules. • Shareholder may qualify for the 20% qualified business income deduction (QBID).
C corporation • Form 1120, *U.S. Corporation Income Tax Return* • IRS Pub. 542, *Corporations* • IRC Subchapter C, §301 through §385	• A legal association carrying on a trade or business organized under state law. • Ownership is through owning shares of stock, and there is no limit on number of shareholders, or type of taxpayer or entity. • Forming a corporation may require complex and expensive legal procedures. Corporations must hold board meetings, shareholder meetings, and keep corporate minutes. Corporations are subject to federal and state regulations. • The life of a corporation is perpetual. Transfers of ownership can be as easy as selling or inheriting stock. • Liquidating a corporation is usually a taxable event, and contributions in exchange for stock may be taxable. • Raising additional capital can be as easy as issuing new shares of stock.	• Shareholders who perform services are paid as Form W-2 employees subject to payroll taxes and reporting rules. • Reasonable wages must be paid and not inflated to reduce corporate tax liability. • Net profits are subject to tax at the corporate 21% rate. Profits distributed as dividends are taxed again on the shareholder's tax return. Tax to the shareholders can be deferred by retaining earnings for business purposes. • Losses do not pass through to shareholders. Business losses must be carried over to a year with profits. Capital losses must be carried over to a year with capital gains. At-risk limitations, hobby loss, and passive loss rules do not apply.

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Business Entity Pros and Cons

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Business Entity Pros and Cons

	Sole Proprietorship
Pros	• No formal creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • No double taxation of profits.
Cons	• No liability protection, except through insurance. • Self-employment tax is assessed on entire net profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners.
Good Fit	• Seasonal or part-time businesses. • Businesses with little liability. • Home-based businesses. • Businesses intended to operate for the owner's life only.

	Single-Member LLC
Pros	• Simple creation process. • Easy to operate and dissolve. • No separate tax return. • Easy to integrate business use of home deductions. • Liability protection for member, except for malpractice. • No double taxation of profits.
Cons	• Self-employment tax is assessed on entire net profit of the business. • Transfer of ownership can be complex. • Limited access to fringe benefits for owners. • Laws regulating LLCs vary widely among states. • Failure to follow statutory requirements can result in loss of LLC status.
Good Fit	• Businesses with potential liability in operations. • Businesses intended to operate for the owner's life only.

	Multi-member LLC
Pros	• Limited liability for all members, except for malpractice or debt guarantees. • Unlimited number of members. • Separate entity from members, allowing for greater flexibility in operations. • Ownership is in the form of membership interest and can be transferred more easily than ownership in a single-member LLC. • No double taxation of profits.
Cons	• Requires a separate tax return. • Laws regulating LLCs vary widely among states. • Failure to follow statutory requirements can result in loss of LLC status.
Good Fit	• Businesses requiring equity capital. • Businesses with potential liability in operations. • Businesses intended to exist beyond the lives of the members. • Businesses expecting changes in ownership over time.

	General Partnership
Pros	• No limit on partner number or type. • Can be used to hold investments in other businesses and consolidate multiple lines of business. • Flexible allocation of profit, loss, and distributions. • Favorable tax treatment when liquidated. • No double taxation of profits.
Cons	• Requires a separate tax return. • Unlimited liability for all partners. • Difficult to dissolve or change ownership without substantial planning. • Requires tracking of basis for partners, both inside and outside the partnership. • Individual partner's share of income is subject to self-employment taxes.
Good Fit	• Two established businesses who wish to work as one. • Partners wishing to consolidate multiple entities into one entity.

Business Entity Pros and Cons

Limited Liability Partnership	
Pros	• Liability protection for limited partners. • Separate entity from partners. • Ownership can be transferred within the rules of the partnership agreement. • Limited partners' liability is limited to their investment in the business. • Limited partners pay self-employment tax on guaranteed payments only. • No double taxation of profits.
Cons	• Must have one general partner with unlimited liability. • Limited liability status for damages can be lost for a variety of administrative reasons. • Restrictions on partners based on entity type. • Requires a separate tax return. • Requires tracking of basis for partners, both inside and outside the partnership.
Good Fit	• Businesses with partners not actively involved in business. • Businesses with equity capital needs. • Businesses with exposure to liability.

C Corporation	
Pros	• No liability for non-active stockholders. • No restrictions on ownership. • Ownership can be transferred through the sale of stock. • Separate entity from stockholders. • Fringe benefits for owner-officers. • Can have ownership interest in any other business entity. • Perpetual existence. • Raising capital can be achieved by issuing stock.
Cons	• Double taxation of profits. • Complex and expensive to create and maintain. • Requires regular board of directors' meetings and minutes. • Requires a separate tax return.
Good Fit	• Businesses with ownership in multiple other entities. • Businesses with significant exposure to liability. • Businesses intended to exist eternally.

S Corporation	
Pros	• Liability protection similar to that of C corporations. • No double taxation of profits. • Ownership is easily transferred through the sale of stock. • Separate entity from stockholders. • Self-employment tax is not assessed on the entire net profit of the business. • Losses can offset shareholders' other taxable income.
Cons	• Complex and expensive to create and maintain. • Requires a separate tax return. • Requires regular board of directors' meetings and minutes. • Requires tracking of basis for stockholders. • Ownership is limited to specific types of entities. • Deductibility of fringe benefits for owner-employees is limited.
Good Fit	• Businesses with significant exposure to liability.

Business Formalities

A common issue with a closely-held business is failure to adhere to business formalities. Trouble can occur when business and personal funds are intermingled, the business is not adequately capitalized, or reasonable compensation for services is not paid.

For example, separation of funds can be a key in preserving the liability protection of the "corporate veil." Courts can pierce the corporate veil if they find the corporation is an "alter ego" of the shareholder, which is likely to occur if shareholders pay personal expenses from the corporation checkbook or vice versa.

Transactions such as capital contributions or loans between the business and the owners can also be recharacterized by the IRS, creating unexpected negative tax consequences.

Contact Us

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- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 73.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

Depreciation

Business Name:

Asset	*Date Purchased*	*Business Use Percentage*	*Cost*	*Date Placed in Service*	*Date Sold or Taken Out of Service*	*Selling Price*	*Trade-In Allowance*

If this is your first year with our firm, please provide a depreciation schedule for all property placed in service in prior years.

Inventory

Inventory at the beginning of the year	
Purchases	
Cost of labor	
Materials and supplies	
Other costs	
Minus: Inventory at the end of the year	
Total	

Car Expenses

Mileage		*Actual Expenses*	
Beginning of year odometer		Gas/oil	
End of year odometer		Insurance	
Business mileage		Parking fees/tolls	
Commuting mileage		Registration/fees	
Other mileage		Repairs/tires	

Retain a daily log to substantiate expenses.

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Business Expenses Worksheet

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Business Expenses Worksheet

Business Name:

Date	Advertising	Commissions and Fees	Contract Labor	Employee Benefit Programs	Insurance (other than health)	Interest	Legal and Professional Fees	Office Expense	Pension and Profit-Sharing Plans	Rent or Lease	Repairs and Maintenance	Supplies	Taxes and Licenses	Utilities	Wages	Other
Totals																

Business Use of Home

Business Use Percentage					
All taxpayers: Business use area			/ Total area of home		(square feet)
Daycare only: Hours used for day care			/ Total hours in year		[8,760 (2025)]
Expenses					
	Direct	*Indirect*		*Direct*	*Indirect*
Mortgage interest			Repairs & Maintenance		
Property taxes			Utilities		
Insurance			Other:		
Rent			Other:		
Depreciation of the Home					
Lower of cost or FMV			Improvements		
Value of land			Casualty loss		

Travel Expenses

City Visited (for per diem)	***Purpose***	***Dates***	***# of days***	***Travel Expenses***	
				Airfare	
				Bus, train, taxi	
				Lodging	
				Parking & tolls	
				Meals (actual receipts)	
				Other:	

Mileage and Expense Log

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Deductible Expenses

In order to be deductible, business expenses for travel, lodging, and meals must be ordinary and necessary.

An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.

Substantiation for Travel, Lodging, and Meals

Special rules apply for substantiation of expenses for travel, lodging, and meals. You must maintain records that include:

- The amount of the expense.
- The time and place of travel.
- The business purpose of the expense.
- The business relationship between you and persons you pay for.

Note: For self-employed individuals, per diem rates for meals (standard meal allowance) may be used in place of actual receipts. Actual receipts must be used for lodging.

Traveling exceptions. Documentary evidence is not needed if any of the following conditions apply.

- The expense, other than lodging, is less than $75.
- You have a transportation expense for which a receipt is not readily available.

Travel and Lodging

Travel expenses include the ordinary and necessary expenses incurred by you (generally for overnight stays) while on temporary travel away from your tax home for business purposes.

Tax home. Generally, your tax home is your regular place of business, regardless of where you maintain your family home. It includes the entire city or general area in which your business is located.

Deductible expenses. Deductible expenses include:

- Air, train, bus, or car travel between your home and the business destination.
- Use of a car for business purposes while at the business destination.
- Transportation (including tips) between the airport or train station and a hotel, between the hotel and a business location, and between business locations or customers.
- Meals, lodging, dry cleaning, and laundry, including tips.

Meals

A deduction for meals is allowed (limited to 50%) if incurred while traveling on business or while meeting a client or customer. The deduction for local meals uses actual costs while the deduction for meals while out of town can use actual costs or the standard meal allowance (per diem rate).

Entertainment. Entertainment expenses are not tax deductible even if directly related to your business. Entertainment includes entertaining guests at nightclubs, at social, athletic, and sporting clubs, on yachts, or on hunting, fishing, vacation, and similar trips.

Mileage and Expense Log

Make:	**Model :**	**Year:**	**Starting mileage on Jan. 1:**	**Ending mileage on Dec. 31:**

Date	*Miles*	*Start/End Point or Paid To*	*Reason for Trip/Business Purpose for Expense*	*Amount*
Total Miles			**Total Expenses**	

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Business Management Tips

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Online Business Resources

www.sba.gov. The U.S. Small Business Administration (SBA) provides programs for businesses in the areas of technical assistance, training and counseling, financial assistance, assistance with government contracting, disaster assistance recovery, advocacy laws and regulations, civil rights compliance, and special interests, such as women, veterans, Native Americans, and young entrepreneurs. The website provides links to numerous information resources.

www.score.org. The Service Corps of Retired Executives (SCORE) is dedicated to helping small businesses get off the ground, grow and achieve their goals. SCORE provides volunteer mentors, free confidential business counseling, free business tools, and inexpensive or free business workshops.

Websites

www.archive.org	Internet Archive Wayback Machine
www.bizstats.com	Business/Industry Statistics
www.bls.gov	U.S. Bureau of Labor Statistics
www.franchise.org	International Franchise Association
www.usa.gov/business	Small Business Resources

Business Plans

A business plan is a written document created to detail all aspects of a business on a comprehensive level. The process of writing a business plan requires significant research into each of the topics discussed. In some cases, the process of researching and writing a business plan will reveal potential problems or lead the individual to choose not to go into business.

A business plan helps to define short- and long-term goals for the business and the methods for measuring the level of success in reaching them. Many banks and investors require a written business plan before lending to or investing in a business. Also, by carefully examining each aspect of a business at its beginning, a business can be structured to create the maximum level of tax advantage for the owners.

Explore the website www.score.org for assistance with writing a business plan.

Start-Up Costs and Capitalization

Start-up costs. Start-up costs are incurred before the start of operations. Typical expenses include the costs of organization, professional consulting, capital equipment acquisition, and leasing a space.

Capital. Cash from the owners or investors is the most common source of capital when beginning a new entity. Business loans are also common and can be secured through private banks or the Small Business Administration (SBA).

SBA loans. The SBA is a federal agency which guarantees certain loans and lines of credit made by banks to small businesses. Loans and lines are available for working capital, asset purchase, and debt refinancing needs.

Use of Budgets

Annual budget. Development of an annual budget generally takes place late in the year prior to the year of the budget and is broken down by month. Financial statements from recently completed periods are used to develop estimates for the budget. Using the budget, costs can be reduced, resources properly allocated, and new goals for the year can be set.

Business Management Tips

Internal Control

Control procedures. Internal control procedures are designed to safeguard the assets of a business. Without them, dishonest employees or owners can misappropriate assets in the form of cash, property, or supplies with little effort.

Separation of duties. Duties which, if conducted by the same individual, would allow for simple concealment of theft should be kept separate. The following are examples of duties that should be performed by different people.

- Receiving, recording, and depositing customer payments.
- Sourcing, approving, ordering, and receiving supplies or merchandise.
- Inputting, approving for payment, and paying vendor bills and payroll.
- Balancing and inputting transactions into bank accounts.
- Counting cash and merchandise on hand at the beginning and end of the day.

Small businesses generally lack sufficient staff to properly separate all duties which should be separated. In this case, increased involvement of owners and management in daily operations of a business can assist in detecting misappropriation of assets.

Mandatory vacations. Many schemes to steal from a business require constant, manual intervention by the person perpetrating the scheme. By having and enforcing a mandatory vacation policy, the time a perpetrator spends away from work may allow a scheme to be uncovered in the course of daily operations. Mandatory vacations should be a minimum of two weeks, during which time the vacationing person has no access to the business or its records.

Environment of detection. If an employee or owner believes embezzlement will be discovered in the normal course of business, it is much less likely one would choose to embezzle. Creating an environment of detection is the process of alerting all employees and owners that systems are in place to detect embezzlement and theft, and that such acts will be prosecuted if perpetrated. This can be accomplished through training, one-on-one conversations, and the establishment of a hotline employees and owners can use to report suspected theft.

Background checks. Background checks during the hiring process allow a business to determine whether a prospective employee has any criminal history. Many background checks also include credit histories to uncover any financial conditions which may make an employee more likely to steal from a business.

Reasons Businesses Fail

Failure rates. Data from the SBA indicates two in 10 new businesses fail within the first year, and only five in 10 businesses survive five or more years.

Reasons for failure. The 10 most common reasons for failure are listed below.

- ***Lack of experience.*** This can apply to a lack of experience in a specific business or in running a business in general.
- ***Insufficient capital.*** Sufficient capital must be in place to support a business until cash flow from operations is adequate.
- ***Poor location.*** Location can be one of the most important factors for business success or failure.
- ***Poor inventory management.*** Keeping too much inventory uses too much capital unnecessarily, while having too little inventory can lead to shortages and customer dissatisfaction.
- ***Over-investment in fixed assets.*** Investing too much too quickly in long-lived assets also uses much needed capital in an unnecessary way.
- ***Poor credit arrangements.*** Lacking access to sufficient, reasonably priced credit.
- ***Personal use of business funds.*** Business funds should not be used for personal purposes.
- ***Low sales.*** Poor knowledge of the market can result in lower-than-expected sales.
- ***Competition.*** Not properly assessing competition can potentially leave a business in a position of needing to compete in a market where it cannot do so and survive.
- ***Unexpected growth.*** Growth without planning for the consequences can lead a thriving business to failure.

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Business Owners—Taking Money Out of a Business

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Business Owners— Taking Money Out of a Business

When taking money out of a business, transactions must be carefully structured to avoid unwanted tax consequences or damage to the business entity. Business owners should follow the advice of a tax professional to make sure financial transactions are controlled and do not cause unanticipated taxation or other negative effects.

For example, a shareholder of a corporation can make a loan to the corporation, and subsequent repayments of principal are not taxable to the shareholder. This may seem straightforward. However, if the loan and repayments are not set up and processed properly, with specific documentation in place, the IRS can reclassify the funding as nondeductible capital contributions and classify the repayments as taxable dividends, resulting in unexpected taxation. A weak loan structure can also create a danger zone where a court can "pierce the corporate veil," resulting in personal liability for the business owner. These negative effects can occur in several different situations.

Intermingling Funds

One of the most dangerous financial mistakes a business owner can make is to intermingle funds, such as paying personal expenses from the business checking account, or paying business expenses from the owner's personal account. This can be done with the best of intentions with the business owner making adjustments in the books to separate the business and personal transactions, but the behavior can leave openings for the IRS or courts to question the integrity of the business entity or the transactions. Failure to maintain complete financial separation between a business and its owners is one of the major causes of tax and legal trouble for small businesses.

Tax problems. Unintended consequences can occur when personal and corporate funds are intermingled. When a shareholder purchases an item for a corporation with personal funds, that shareholder is considered to have provided funds or made a contribution to the corporation. When a shareholder provides funds to or on behalf of a corporation, there are several different types of tax treatment that may apply, depending on the circumstances, and can be classified as one of the following transactions.

- Capital contribution.
- Loan to the corporation.
- Repayment of a loan from the corporation.
- Expense reimbursement.

On the other hand, when an individual takes funds from a corporation, the transaction can be classified as:

- Taxable dividend or distribution of profits.
- Nontaxable distribution.
- Nontaxable expense reimbursement.
- Taxable wages.
- Loan to the shareholder.
- Repayment of a loan from the shareholder.

Failure to carefully structure transactions can result in otherwise nontaxable transactions becoming taxable, in addition to a court piercing the corporate veil.

Personal use of corporate assets. If corporate assets are used for personal purposes, the IRS can reclassify expenses reported on the corporation tax return as expenses attributable to the shareholder rather than the corporation. On the other hand, if a corporation uses personal assets owned by the shareholder, this could indicate lack of separation of the shareholder and corporation.

Business Owners— Taking Money Out of a Business

Taking Money Out

Sole Proprietorships

A sole proprietor is taxed on self-employment income without regard for activity in the business bank account. A sole proprietor should never pay himself or herself wages, dividends, or other distributions. A sole proprietor may take money out of the business bank account with no tax ramifications.

Wages

One way for a business owner to take money out of a corporation is through wages for services performed. Wages are appropriate only for C corporations and S corporations, not for sole proprietorships or partnerships. Owners are treated as employees, payroll taxes and income taxes are withheld, and the corporation issues Form W-2, *Wage and Tax Statement,* to the business owner.

Reasonable Wages

For C corporations and S corporations, there are incentives to skew wages one way or the other for purposes of tax savings. In a C corporation, wages are deductible by the corporation but dividends are not, creating incentive for a C corporation shareholder to inflate the wages for higher deductions. In an S corporation, wages are subject to payroll taxes but flow-through income is not, creating an incentive for artificially low wages. Both C corporations and S corporations are required by law to pay reasonable wages, which approximate wages that would be paid for similar levels of services in unrelated companies.

Guaranteed Payments

Guaranteed payments to partners are the partnership counterpart to corporate wages. One major difference is with guaranteed payments, there is no withholding for payroll taxes or income tax. These amounts are computed and paid on the partner's individual Form 1040.

Dividends

Dividends are generally the means by which a C corporation distributes profits to shareholders. Amounts up to the C corporation's earnings and profits are taxable to the shareholder. Although flow-through income from S corporations or partnerships are often called dividends, they are not treated as dividends under tax rules.

Pass-Through Income—S Corporations and Partnerships

Net income from S corporations and partnerships flows through to the shareholder or partner's individual tax return. Pass-through income is reported without regard for whether or when the income is distributed to the shareholder or partner. Distributions of cash to an S corporation shareholder or partner are not taxable to the individual until the person's cost basis reaches zero.

One-Class-of-Stock Rule

An S corporation is allowed to have only one class of stock. If an S corporation does not make distributions to all shareholders based on the percent of stock owned, this rule may be violated and the S corporation status may be terminated. The one-class-of-stock rule must be adhered to whenever making distributions from an S corporation's bank account.

Loans

A corporation or partnership can receive loans from shareholders or partners and, on the other hand, a corporation or partnership can make loans to shareholders or partners. There is generally no taxable event when a corporation or partnership repays a loan from a business owner, and no taxable event when a corporation or partnership makes a bona fide loan to a shareholder or partner. However, failing to adhere to necessary formalities can put these transactions in danger, allowing the IRS to step in and reclassify the transactions, resulting in taxable income for the business owners.

Contact Us

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- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 73.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

TAX YEAR
2025

Business Use of Home

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LEXINGTON, NC 27292
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FRANK'S TAX SERVICE
TAX PREP AND PROBLEM RESOLUTION

Qualifying for Deduction

To take a business deduction for home office expenses, you must use your home under one of the following scenarios.

- You have an area in your home that is regularly and exclusively used as your principal place of business.
- You have an area in your home where you regularly and exclusively meet with patients, clients, or customers.
- You have a separate structure, not attached to your home, which is used in connection with your trade or business.
- You have an area in your home used on a regular basis for the storage of inventory or product samples.
- Your home is used as a daycare facility.

Business Use of Home Expenses

Some expenses are deductible whether or not you use your home for business. Others are deductible only if the home is used for business.

Deductible Regardless*	Deductible Only If for Business**
• Real estate taxes. • Mortgage interest. • Home equity interest. • Casualty losses.	• Homeowner's insurance. • Rent. • Repairs and maintenance. • Security system. • Utilities and services. • Depreciation (deductible after applying deduction limitation to above expenses).

* Deductible as an itemized deduction, subject to limitation.
** Deductible as a business expense pro-rated for the amount of the business use of the home

Direct Expenses

Expenses that benefit only the area exclusively used for business, such as painting or repairs in the home office, are direct expenses that are fully deductible.

Indirect Expenses

Expenses for keeping up and running the entire home, such as insurance, utilities, and general repairs, are indirect expenses that are deductible based on the percentage of the home used for business.

Unrelated Expenses

Expenses for the part of the home not used for business, such as painting a room not used for business, are unrelated expenses that are not deductible.

Telephone

The basic local telephone service for the first telephone line is nondeductible even if it is used for business. Any additional charges for long distance or a second line into the home used for business are deductible.

Depreciation

A qualified home office is considered nonresidential real property depreciable over 39 years. For home office depreciation, the basis in the home is the smaller of:

- The fair market value (FMV) of the home minus the FMV of land on the date the home was first used for business, or
- The home's cost plus permanent improvements minus casualty losses minus the cost of land on the date the home was first used for business.

Home Improvements

Permanent improvements prior to using the home for business are added to the basis of the home and depreciated as part of the adjusted basis of the home. The cost of improvements made after using the home for business that affect the area of the home used for business are depreciated separately.

Example: *Rita had a new roof put on her home in 2010. She first used her home for business in 2014. She also replaced her furnace*

Business Use of Home

in 2025. The cost of the new roof from 2010 is added to the basis of her home, and the business portion is depreciated over 39 years, starting in 2014. The business portion of the furnace cost is depreciated as a separate asset over 39 years, starting in 2025.

Calculating Business Use of Home Deduction

Business Percentage

The business percentage equals the area of the part of the home used for business divided by the area of the whole house. Any reasonable method may be used to determine the business percentage.

The following are two common methods.
- Divide square footage of area used for business by total square footage of home.
- If all rooms are about the same size, divide the number of rooms used for business by total number of rooms in the home.

Part-Year Use

Do not include home expenses in the business use equation for any period during the year where the home was not used for business.

Daycare Facility

The business percentage of an area exclusively used for business in a daycare facility is calculated under the business percentage method above. For the portion of the home regularly used, but not exclusively used for the daycare business, multiply that portion by the business percentage of time.

Example: *Jane uses her 1,600 square foot basement for her daycare business. The total area of her home is 3,200 square feet so her business-use percentage is 50% (1,600 ÷ 3,200). Her daycare used the basement for a total of 3,000 hours during the year. The total number of hours for 2025 was 8,760 (24 hours × 365 days) so her daycare time percentage is 34.25% (3,000 ÷ 8,760). Any direct expenses, such as repainting the basement, are multiplied by 34.25% to determine the deductible business portion of the expense. Any indirect expenses, such as utilities, are multiplied by 17.13% (50% × 34.25%) to determine the deductible business portion of the expense.*

➲ ***Did You Know?*** In many cases, the basement and garage may be included in the total square footage of a daycare provider's home when calculating the business-use percentage. In addition to regularly used rooms, the business-use area can include:
- Entryways, halls, food preparation areas, and bathrooms.
- Basement with laundry or tool rooms, storage or furnace area, etc.
- Garage where business car is parked or where household tools, trash cans, or stored daycare items are kept.

Calculating Time Spent on Daycare

You should keep a log reflecting time spent conducting the daycare business, including dates and hours each person was in your care, and additional time spent organizing, preparing meals, and cleaning up.

Deduction Limitation

The business use of home deduction is limited to net income from the business.

Carryover of Unallowed Expenses

Deductions not allowed due to the net income limitation are carried over to the following year. They are added to current expenses from each category and subject to the deduction limit for that year for that category.

Simplified Option for Home Office Deduction

The simplified option may be calculated as follows.
- A standard deduction is allowed of $5 per square foot of home used for business, limited to a maximum of 300 square feet.
- Allowable home-related itemized deductions such as mortgage interest and real estate taxes are claimed in full on Schedule A, instead of apportioned between the business form and Schedule A.
- No home depreciation deduction is claimed and no later recapture of depreciation is required for the years the simplified method is used.

Note: Although recordkeeping is simplified, this option does not change the criteria for who may claim a home office deduction.

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