

# UNDERSTANDING TAXES

For any type of small business, different types of federal, state, and city taxes must be paid. Records must be kept that provide information needed to determine your tax liability and make the required deductions. These taxes include:

**Federal Taxes:** Employee Income Tax and Social Security and Medicare Tax, Excise Tax, Owner-Manager's and/or Corporation Income Tax, Unemployment Tax

**State Taxes:** Franchise Tax, Income Taxes, Unemployment Insurance, Sales Use Tax, and State Disability Insurance.

**Local Taxes:** Personal Property Tax, Real Estate Tax

## Federal Taxes

Information and assistance regarding federal tax obligations and requirements can be obtained from:

**Internal Revenue Service**

5104 North Blyth Avenue

Fresno CA 93722

(800) 829-1040

[www.irs.gov/businesses](http://www.irs.gov/businesses)

The IRS supplies several booklets at no cost, containing needed information about federal taxes. These include:

- Tax Guide of Small Business
- Employer's Tax Guide (Circular E)
- Your Federal Income Tax
- Your Business Tax Kit

In addition, the Fresno IRS office offers a free monthly workshop to explain how federal taxes relate to your business. These workshops provide an introduction to business taxes, highlight tax benefits and obligations connected with a small business, and emphasize employer tax responsibilities. For brochures and/or workshop schedules, contact the above office.

Current online resource guide:

<http://www.irs.gov/businesses/small/index.html>

Contact the IRS via phone (703) 487-4608, fax (703) 605-6746, or e-mail at [helpdesk@fedworld.gov](mailto:helpdesk@fedworld.gov). This CD is a source of federal tax and other regulatory information as well as information important to small business entrepreneurs. It contains business tax forms, instructions, and publications needed by small business owners. It also provides information on preparation of a business plan, finding financing for your business, and much more.

## **Employer Identification Number**

An Employer's Identification Number (EIN) must be obtained prior to starting your business. An EIN identifies your business for federal and state tax purposes. You may need to get a new EIN if the form of organization of your business changes or the ownership of your business changes.

To apply for an EIN, use form SS-4, Application for EIN. These forms are available from the Internal Revenue Service. The application should be made early enough to allow time for processing the forms for an EIN to be issued. For additional information call the IRS toll-free at (800) 829-1040.

## **Federal Income Tax Withholding**

Any employer of one or more persons must withhold federal income taxes from wages paid to employees.

For each employee, you should obtain a withholding exemption certificate (Form W-4) from the District Director of the Internal Revenue Service, and have the employee complete the form. Based on the information provided by the employee, the amount of taxes is withheld from the wage payments. Generally, income tax must be withheld from wages if the wage for any payroll period is more than the amount of the employee's withholding allowances (per W-4) for the period.

A payroll may be daily, weekly, biweekly, or monthly. The amount to be withheld can be determined by reading Circular E, furnished by the IRS. There should be no withholding for those employees who claim "exempt" on Form W-4. Those employees must renew their exempt status every year by filing a new W-4 by February 15th. Otherwise, an employee need only fill out a new W-4 when the situation changes (marital status, address or withholding allowances).

You are required to deposit with the IRS the funds withheld from the employee's wages. You must file quarterly reports with the District Director of the Internal Revenue Service. You must also file an annual reconciliation of the quarterly reports with copies of the withholding statements. If you neglect to, or improperly file reports, penalties and excess payments may be levied.

The specific records you must keep for income tax withholding are:

- Each employee's name, address, and Social Security number.
- The total amount and date of each wage payment and the period of time payment covers.
- The amount subject to withholding for each wage payment.
- The amount of withholding tax collected on each payment and the date it was collected.
- If the taxable amount is less than the total payment, the reason.
- Copies of any statements furnished by employees relating to nonresident alien status, residence in Puerto Rico or the Virgin Islands, or residence or physical presence in a foreign country.
- The fair market value and date of each payment of non-cash compensation

made to a retail commission salesperson, if no income tax was withheld.

- Information about the amount of each payment for wage continuation plans.
- The withholding exemption certificates (Form W-4) for each employee.
- Any agreement between you and your employee for the voluntary withholding of additional amounts of tax.
- The dates in each calendar quarter in which the employee worked for you, but not in the course of your business or trade, and the amount paid for that work.
- Copies of statements given to you by employees reporting tips received in their work, unless the information shown on the statements appears in another item on the list.
- Requests by employees to have the tax withheld figured on the basis of their individual cumulative wages.
- The Forms W-5, Earned Income Credit Advance Payment Certificate, of the employees who are eligible for the earned income credit and wish to receive their payment in advance rather than when they file their income tax return.

An employee's Earnings Ledger, which you can be purchased at most office supply stores, normally has space for the information required in the first four items above.

### **Social Security Tax (FICA)**

FICA (Federal Insurance Contribution Act) is a tax collected by the IRS to fund Social Security and Medicare distributions. Anyone who owns a business and employs one or more persons is required to participate in the payment and collection of the FICA tax. The employer pays a percentage of wages for each employee. The Social Security portion of the tax is matched by the employee on all wages received up to a maximum amount of earnings. The Medicare portion of the tax is matched by the employer without any wage limits. The employee's share of the Social Security payment is deducted by the employer at the end of each pay period.

It is not necessary to pay the employer portion of FICA on tip income. Tip income should be reported by all employees who receive more than \$20 in tips per month, by the 10th of the following month. They can use Form 4070, Employees' Report of Tips to Employer.

Self-employed individuals pay a self-employment tax (SECA). This tax provides Social Security and Medicare coverage for the self-employed, and it is paid in place of the FICA tax.

You also must maintain the following information in your records on Social Security taxes of your employees:

- The amount of each wage payment subject to FICA tax.
- The amount of FICA tax collected for each payment and the date collected.
- If the total wages payment and the taxable amount differ, the reason why they do.

For further information on Social Security taxes contact the Internal Revenue Service. Because of the nature of Social Security taxes, assistance in setting up records should be requested as soon as a business is formed.

## **Federal Unemployment Tax (FUTA)**

The federal unemployment system, together with the state system, provides for payments of unemployment compensation to workers who have lost their jobs. Payments in kind (wages not paid in money) and tips must be included in wages paid to determine federal unemployment taxes.

Additional information required by the Federal Unemployment Tax Act (FUTA):

- The total amount paid to the employees during the calendar year.
- The amount of compensation subject to the unemployment tax.
- The amount you paid into the state unemployment fund.
- Any other information required to be shown on the unemployment tax return, and amount of the tax.

For more information contact:

**Internal Revenue Service**

Fresno CA 93888

(800) 829-1040

or

**Internal Revenue Service**

2384 Professional Parkway

Santa Maria, CA 93455

(805) 352-0355

## **California Taxes and Insurances**

### **Franchise and Income Tax**

For the State of California net income for corporations is generally the same as that determined for federal income tax purposes with certain exceptions. Income of partnerships or sole proprietorships is taxed as the personal income of the proprietor. The California personal income tax system is patterned after federal income tax law, including a comprehensive system for withholding personal income taxes. Taxpayers not subject to withholding or whose expected tax liability exceeds the amount withheld must pay estimated taxes quarterly. You should see your accountant for more complete information.

Annual tax returns and full payment are due by April 15th for most taxpayers. Information on tax rates and credits is available from the Franchise Tax Board.

**Franchise Tax Board**

(800)852-5711

[www.ftb.ca.gov](http://www.ftb.ca.gov)

If your business is defined as a "employer" under the California Unemployment Insurance Code, then you must register with the California Employment Development Department to obtain a state employer identification number. By law, the California Employment Development Department administers the reporting, collection, refunding, and enforcement

of state personal income taxes required to be withheld by employers. A business applying for a Fuel Tax Permit or Sales Tax Permit from the State Board of Equalization is simultaneously registered with the Employment Development Department. Registration must be within 15 days of the first payment of wages. No fee is required for registration. Most employers who withhold California personal income taxes already report to this Department under the law relating to unemployment and disability compensation.

The Employer's Tax Guide (form DE-44) provides extensive instructions on requirements and procedures for withholding, filing, and remitting personal income taxes. For a copy of this form and/or additional information, contact:

**California Employment Development Department**

4111 Broad Street  
San Luis Obispo CA 93401  
(805) 788-2697  
[www.edd.ca.gov](http://www.edd.ca.gov)

**State Disability Insurance**

California's Disability Insurance (SDI) program provides benefits to eligible workers who suffer a loss of wages when they are unable to perform their usual work because of non-occupational illness or injury, or pregnancy. It applies roughly to the same employees as the state's unemployment insurance program. The disability insurance program is financed by taxes withheld from wages of covered workers.

Employers are responsible for withholding, and paying to the Employment Development Department, contributions from employees' subject wages. Employers are liable for the Disability Insurance contribution, whether or not such contribution has been deducted from the employee's wages.

Disability Insurance, which covers non-occupational disabilities, should not be confused with workers compensation insurance, which relates to work-related injury or illness. However, if the weekly benefit rate for a workers compensation claim is less than that which would be payable under disability insurance coverage, disability benefits may be used to pay the difference.

**Workers Compensation Insurance**

California law requires all employers to carry workers compensation insurance by certification or self-insurance. Premiums are based on payroll levels and the type of occupation insured; the California Department of Industrial Relations administers the program. For further information and specific requirements on workers compensation insurance, contact:

**California Department of Industrial Relations**

Information & Assistance  
1562 Grand Avenue  
Grover Beach CA 93433  
(805) 481-3296

## **Sales and Use Tax**

You must apply to the State Board of Equalization for a seller's permit for each place of business you operate.

The sales tax is imposed on gross receipts from retail sales at a current rate, consisting of a state rate, a county rate, and a local (city) rate. For current rates, please go to <http://www.boe.ca.gov/app/rates.aspx>. These rates are always subject to change by the state, county and incorporated cities.

Most permit holders file sales tax returns quarterly, however, the Board requires many taxpayers to file monthly or annually instead. The Board has developed Form B-451 for use by cities and counties in order to inform those going into business of the need for a seller's permit. The Board also conducts an ongoing program to ensure that taxpayers are neither over nor under paying. Complete records of all business transactions—including sales receipts, purchases, and other expenditures—must be maintained for at least four years and available at all times for inspection by Board personnel. For additional information, contact:

### **State Board of Equalization**

(800) 400-7115

[www.boe.ca.gov](http://www.boe.ca.gov)

## **State Unemployment Insurance**

Employers paying more than \$100 in wages in any calendar quarter and employing one or more workers generally are subject to the California Unemployment Insurance Code.

The California Employment Development Department provides an Employer's Guide to the Unemployment Insurance Code of California (DE 4525), which should be consulted for details on these procedures. Unemployment Insurance is financed entirely by taxes paid by the employer.

Employer contributions are payable quarterly, on or before the last day of the month, following the close of the calendar quarter. Late payments incur interest charges and possible additional penalties.

## **Employment Tax Periods**

You must use the calendar quarter for withheld income tax and Social Security tax. You must use the calendar year for federal unemployment tax and W-2's.

## **Records of Employers**

You must keep all your records on unemployment taxes (income tax withholding, Social Security and federal unemployment tax) for at least four (4) years after the due date of the return or after the date the tax is paid, whichever is later. In addition to the items required for each specific type of employment tax, your records also should contain your employer identification number, copies of the returns you have filed, and the dates and deposits made.

## **Business Tax Certificate**

A business tax certificate is issued for tax purposes only, and does not constitute a permit or authorization by the issuing entity to conduct a business.

In addition to having a business tax certificate, you must comply with zoning and occupancy law, building codes, traffic regulations, and other specific regulations. Permits from other city or county departments may be required to ensure your compliance. It is your responsibility to obtain any permits required for the conduct of your business.

Upon your application for a business tax certificate, information regarding your business will be sent to the other departments of the city or county which may have regulatory authority over your business. It is to your benefit, therefore, to obtain all appropriate permits before starting your business. If you do not, you may incur additional expense and penalties at a later time for your failure to have the proper permits.

Check with the local government entity as to the full licenses/permits needed. For the county, contact:

### **County Business Licenses Department**

County Government Center  
1055 Monterey Street Room D290  
San Luis Obispo CA 93408  
(805) 781-5832  
[www.ci.san-luis-obispo.ca.us](http://www.ci.san-luis-obispo.ca.us)

and

### **County Planning Department**

County Government Center, Room 200  
976 Osos Street  
San Luis Obispo CA 93408  
(805) 781-5600