

Disclaimer: The following information is intended as general information only and does not represent tax advice to any individual or entity, either express or implied. Laws and regulations vary by jurisdiction and change from time to time; compliance with such standards depends on the particular circumstances. Any reliance on the information is solely at the user's own risk. Before making personal or business tax decisions, you are encouraged to seek professional tax advice.

Guide to Income Taxes for Solo Practitioners and Small Firms

Compliments of:
Wayne A. Jarrett, EA, JD
W. A. Jarrett Co., LLC
1919 Pennsylvania Avenue, NW, Suite 760
Washington, DC 20006
(202) 658-7882
www.WAJarrett.com

PART I: ESTIMATED TAX PAYMENTS – This section applies to everyone who earns income not subject to withholding.

A. Federal

- *Who must make Federal estimated tax payments?*
- *When are estimated tax payments due?*
- *When is the first payment due?*
- *How do I calculate the amount of each payment due?*

B. District of Columbia

- *Who must make DC estimated tax payments?*
- *When are estimated tax payments due?*
- *How do I calculate the amount of each payment due?*

PART II: EMPLOYMENT TAXES – This section applies to firms with one or more employees for whom income taxes need to be withheld.

A. Federal

- *Who must withhold and pay Federal employment taxes?*
- *How much do I withhold and how much do I have to pay?*
- *When do I have to deposit the taxes?*
- *How do I deposit employment taxes?*
- *What reports do I have to file?*

B. District of Columbia

- *Who must withhold and pay DC employment taxes?*

- *How much do I withhold and how much do I have to pay?*
- *When do I have to pay?*
- *What reports do I have to file?*

PART III: ENTITY TAXATION – This section gives a brief and general description of what types firms may be required to pay income taxes at the entity level.

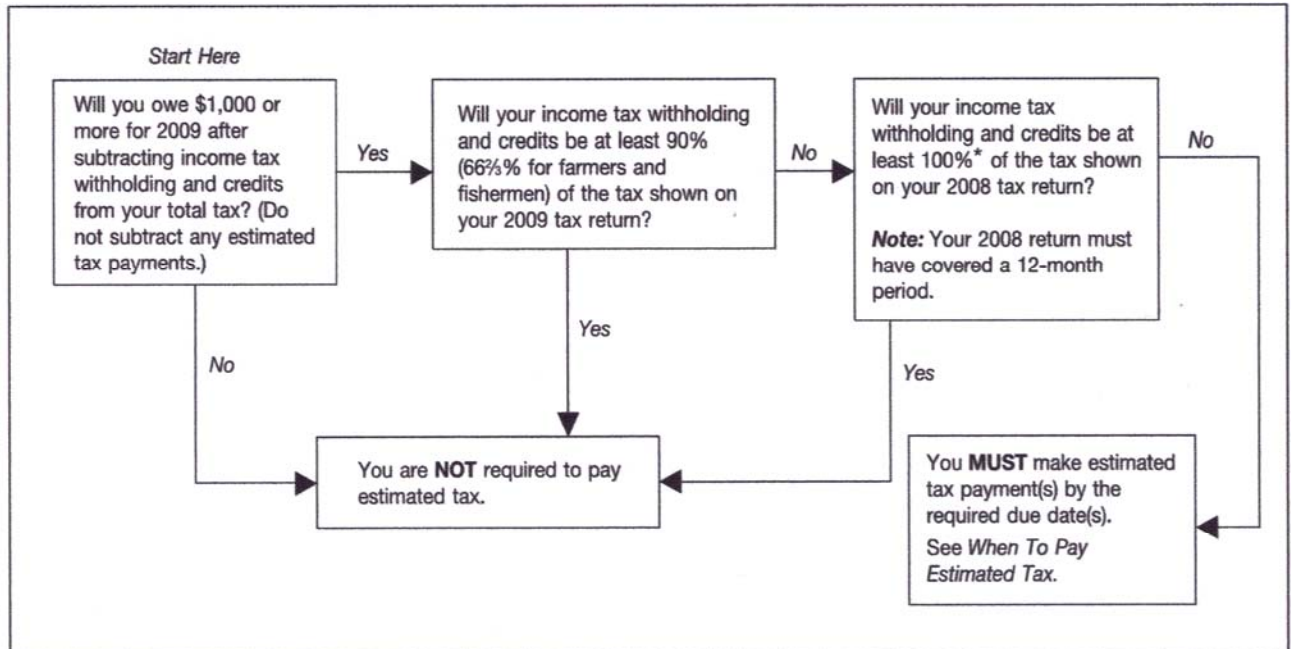
PART IV: FORMS & SCHEDULES – This section identifies the income tax forms, schedules and publications commonly used for individual and entity tax filings.

- *Estimated Taxes*
- *Employment Taxes*
- *Individuals, Sole Proprietorships and Single-Member LLCs*
- *Partnerships and entities taxed as partnerships*
- *Personal Service Corporations*

PART I: ESTIMATED TAX PAYMENTS

A. Federal

Who must make Federal estimated tax payments?



* 110% if less than two-thirds of your gross income for 2008 and 2009 is from farming or fishing and your 2008 adjusted gross income was more than \$150,000 (\$75,000 if your filing status for 2009 is married filing a separate return); 90% if you certify that more than 50% of your gross income in 2008 was income from your small business that had an average of fewer than 500 employees in 2008, and your 2008 AGI was less than \$500,000 (\$250,00 if married filing separate returns in 2009).

When are estimated tax payments due?

For estimated tax purposes, the year is divided into four payment periods. Each period has a specific payment due date. If you do not pay enough tax by the due date of each of the payment periods, you may be charged a penalty even if you are due a refund when you file your income tax return. The payment periods and due dates for estimated tax payments for a calendar-year taxpayer are:

For the period:

Jan 1 – March 31

April 1 – May 31

June 1 – August 31

Sept 1 – Dec 31

Due date:

April 15

June 15

September 15

January 15 next year*

* If you file the 2009 Form 1040 or Form 1040A by February 1, 2010 and pay the rest of the tax owed, you do not need to make the payment due on January 15, 2010.

When is the first payment due?

You do not have to make estimated tax payments until you have income on which you will owe the tax. The first payment is due by the due date for the period during which you have income subject to estimated tax – e.g., if your first income subject to estimated tax is earned in June, your first estimated tax payment is not due until September 15.

How do I calculate the amount of each payment due?

If your primary objective when calculating the estimated taxes due is to avoid penalties for underpayment, the amount due can be calculated quite simply. Be advised, however, that this method is not based upon expected tax liability and can therefore result in an under- or overpayment of the actual tax owed. If you have the dual objective of avoiding penalties for underpayment and making estimated tax payments that will most accurately reflect your actual tax liability, calculating the estimated tax payments due is more complicated.

The simplest method for avoiding penalties is to make sure that income taxes withheld and estimated tax payments total 100% of the taxes shown on your prior year's tax return. (110%, if your 2008 adjusted gross income was more than \$150,000 or if you were married filing separately with an adjusted gross income of more than \$75,000.) Payments and withholdings should be made equally over the four periods.

Example 1: You are married filing jointly, and your 2008 tax return showed adjusted gross income of \$185,000 and total taxes of \$42,000. Without regard to 2009 earnings, penalties for underpayment of estimated taxes will be avoided if \$11,550 is paid through withholdings and/or estimated payments during each of the four periods (with payment due dates of April 15, June 15, September 15, 2009 and January 15, 2010), for total payments of \$46,200 (110% of 2008 taxes, since prior year's AGI exceeded \$150,000).

Example 2: You are a solo practitioner, filing status single, and your 2008 tax return showed adjusted gross income of \$100,000 and total taxes of \$25,000. Without regard to 2009 earnings, penalties for underpayment of estimated taxes will be avoided if \$6,250 is paid during each of the four periods (with payment due dates of April 15, June 15, September 15, 2009 and January 15, 2010), for total payments of \$25,000 (100% of 2008 taxes).

If you wish to base your payments on current year tax liability, rather than the prior year's, you must pay an amount equal to 90% of the current year's tax in order to avoid underpayment penalties. Under this method, you must calculate your expected adjusted gross income, taxable income, taxes, deductions and credits for the year. A worksheet, instructions and tax tables are provided by the IRS with Form 1040-ES and can be found at <http://www.irs.gov/pub/irs-pdf/f1040es.pdf>

Example: You are married filing jointly. Your estimated taxable income for 2009 will be \$170,000, on which taxes will be 36,000. Total taxes that must be paid to avoid penalties will be \$32,400 (90% of \$36,000). Part of the taxable income will be salary

earned by your spouse, from which \$15,000 in taxes will be withheld. Total of additional, estimated payments to be made is \$17,400, due in quarterly installments of \$4,350 each on April 15, June 15, September 15, 2009 and January 15, 2010.

B. District of Columbia

Who must make DC estimated tax payments?

If you are required to file a DC income tax return and expect to owe \$100 or more after subtracting your tax withheld and any credits, you must pay estimated taxes.

When are estimated tax payments due?

Payments are due quarterly, on the same dates that Federal estimated payments are due – i.e., April 15, June 15, and September 15 of the current year, and January 15th of next year.

How do I calculate the amount of each payment due?

As with the IRS, penalties for underpayment can be avoided in DC if your withholdings, credits and estimated payments equal:

- At least 90% of your current year's DC income tax; or
- 100% of last year's DC income tax (assuming last year's return covered a full 12-month period)

If you wish to avoid penalties by paying an amount equal to 100% of last year's tax, the payments and withholdings should be made equally over the four periods.

If you expect this year's income to be different from last year and wish to base your estimated payments on current tax year liability, use the worksheet found in the instructions to Form D-40ES, which can be found online at:

http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/individual_income_and_fiduciary_tax_forms--2008/2009_d-40es_final.pdf

PART II: EMPLOYMENT TAXES

A. Federal

Who must withhold and pay Federal employment taxes?

If you have one or more employees, you generally must:

- withhold Federal income tax from your employees' wages,
- withhold part of Social Security and Medicare taxes from your employees' wages and you pay a matching amount yourself, and
- pay FUTA tax.

You will need an employer identification number (EIN) for proper reporting of employment taxes, which can be obtained online at <https://sa2.www4.irs.gov/modiein/individual/index.jsp>

How much do I withhold and how much do I have to pay?

Federal income tax withholding: amount is determined by information submitted by each employee on Form W-4 and calculated with the wage withholding tables found in Publication 15-T: <http://www.irs.gov/pub/irs-pdf/p15t.pdf>

Social Security tax: 6.2% of an employee's wages withheld and a matching 6.2% is paid by the employer (12.4% total) on the first \$106,800 (as of 2009) of an employee's wages.

Medicare tax: 1.45% of an employee's wages withheld and a matching 1.45% is paid by the employer (2.9% total). Unlike the Social Security tax, there is no wage base limit for the Medicare tax; all covered wages are subject to the tax.

FUTA (Federal Unemployment Tax Act) tax: Nothing withheld from employee. Employer pays 6.2% of the first \$7,000 paid to each employee as wages during the year. You are subject to FUTA tax in 2009 if either:

- a.) You paid wages of \$1,500 or more in any calendar quarter in 2008 or 2009, or
- b.) You had one or more employees for at least some part of a day in any 20 or more different weeks in 2008 or 20 or more different weeks in 2009.

Note: a credit can generally be taken against FUTA tax for amounts paid into State unemployment funds, but the credit is limited to 5.4% of \$7,000.

When do I have to deposit the taxes?

Income tax withheld and both the employer and employee Social Security and Medicare taxes must be deposited by the employer either monthly or semiweekly, depending upon prior period activity.

New employers pay monthly for the first calendar year of business. Under the monthly deposit schedule, deposit employment taxes for the month by the 15th day of the following month – e.g., employment taxes withheld in July must be deposited by August 15th.

Existing employers may have to pay semiweekly, rather than monthly, depending upon the amount reported during the “lookback period,” as described in IRS Publication 15:

http://www.irs.gov/publications/p15/ar02.html#en_US_publink100011714 If semiweekly is required, the deposit schedule is as follows:

Semiweekly Deposit Schedule

IF the payday falls on a . . .	THEN deposit taxes by the following . . .
Wednesday, Thursday, and/or Friday	Wednesday
Saturday, Sunday, Monday, and/or Tuesday	Friday

FUTA Taxes are deposited quarterly according to the following schedule:

Quarter	Ending	Due Date
Jan.–Feb.–Mar.	Mar. 31	Apr. 30
Apr.–May–June	June 30	July 31
July–Aug.–Sept.	Sept. 30	Oct. 31
Oct.–Nov.–Dec.	Dec. 31	Jan. 31

How do I deposit employment taxes?

There are two methods to make deposits:

- 1.) Electronically, using the Electronic Federal Tax Payment System:
<https://www.eftps.gov/eftps/> (some employers are required to submit electronically – see IRS Publication 15 for details).
- 2.) Mail or deliver IRS Form 8109-B and a check, money order, or cash to a financial institution that is an authorized depository for Federal taxes.

What reports do I have to file?

Form 941. Each quarter, all employers who pay wages subject to income tax withholding (including withholding on sick pay and supplemental unemployment benefits) or social security and Medicare taxes must file Form 941, Employer's QUARTERLY Federal Tax Return, unless the employer has an employment tax liability of \$1,000 or less for the year, in which case Form 944 is filed. Form 941 must be filed by the last day of the month that follows the end of the quarter.

Form W-2. At the end of the year, the employer must complete Form W-2, Wage and Tax Statement to report wages, tips and other compensation paid to an employee. A copy of this form must be given to the employee by January 31st after the end of the year. You must also send a copy of the W-2 to the Social Security Administration (SSA).

B. District of Columbia

Who must withhold and pay DC employment taxes?

Every employer who pays wages to a DC resident and/or withholds DC income tax from an employee must file a DC Withholding Tax Return. If your liability exceeds \$25,000 in any month, you must file electronically.

How much do I withhold and how much do I have to pay?

DC income tax: Amount to withhold based upon information provided by employee on Form D-4 and in accordance with the DC tax withholding table:

http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/2009_fr-230_final_revised.pdf

DC unemployment insurance tax: Employers who are newly liable for unemployment compensation taxes are assigned a standard tax rate equal to the average rate of contributions paid by all employers during the preceding year, or 2.7 percent, whichever is higher, on the first \$9,000 of an employee's wages.

When do I have to pay?

Income tax withheld: Monthly, by the 20th day of the month following the month being reported.

Unemployment insurance tax: Quarterly, with due dates of April 30, July 31, October 31 and January 31.

What reports to I have to file?

FR-900M Employer Withholding Tax – Monthly Return, due each month by the 20th:

http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/2008_fr-900m.pdf

FR-900B Employer Withholding Tax Annual Reconciliation and Report, due annually on by January 20th: http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/2008_fr-900m.pdf

Employer's Quarterly Contribution and Wage Report (Form UC-30) – due quarterly on April 30, July 31, October 31, and January 31. Form provided by Tax Division, Office of Unemployment Compensation.

PART III – ENTITY TAXES

In general, law firms will not incur Federal or DC tax liability at the entity level. Exceptions to this rule may be limited liability companies or partnerships electing to be treated as a corporation for tax purposes, and personal service corporations.

Personal service corporations incur a Federal tax at a flat rate of 35% of profits, but tax liability is generally avoided by paying out profits in the form of salaries to its employee shareholders.

Any other type of entity electing to be taxed as a corporation will have its profits taxed according to the corporate tax rate schedules. This election is generally avoided, as it results in a firm's profits being taxed twice: first at the entity level, and then at the owner level when profits are distributed.

For sole proprietorships, partnerships, LLCs and professional associations that do not elect to be taxed as a corporation, the entity does not pay taxes on profits and the tax liability flows through to the owners/partners/members, to be paid at the tax rate applicable to the individual owner/partner/member.

DC imposes a franchise tax on both incorporated and unincorporated businesses, but an exclusion applies to any business deriving more than 80% of gross income from personal services rendered by individual members of the partnership or other entity in conducting or carrying on any trade or business in which capital is not a material income-producing factor. Therefore, law firms generally are not liable for the DC franchise tax.

PART IV: TAX FORMS, SCHEDULES AND PUBLICATIONS

Estimated Taxes

IRS Form 1040-ES, Estimated Tax for Individuals: <http://www.irs.gov/pub/irs-pdf/f1040es.pdf>

IRS Publication 505, Tax Withholding and Estimated Tax:
<http://www.irs.gov/pub/irs-pdf/p505.pdf>

DC Form D-40ES, Estimated Payment for Individual Income Tax:
http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/individual_income_and_fiduciary_tax_forms_--_2008/2009_d40es_fill-in.pdf

Employment Taxes

IRS Form SS-4, Application for Employer Identification Number:
<http://www.irs.gov/pub/irs-pdf/fss4.pdf> (or can apply online at:
<https://sa2.www4.irs.gov/modiein/individual/index.jsp>

IRS Form W-4, Employee's Withholding Allowance Certificate:
<http://www.irs.gov/pub/irs-pdf/fw4.pdf>

DC Form D-4, Employee Withholding Allowance Certificate:
http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/individual_income_and_fiduciary_tax_forms_--_2008/2008_d-4_noyear_draft.pdf

IRS Publication 15, Employer's Tax Guide: <http://www.irs.gov/pub/irs-pdf/p15.pdf>

IRS Publication 15-A, Employer's Supplemental Tax Guide (Supplement to Publication 15): <http://www.irs.gov/pub/irs-pdf/p15a.pdf>

IRS Publication 393, Federal Employment Tax Forms: <http://www.irs.gov/pub/irs-pdf/p393.pdf>

IRS Form 941, Employer's Quarterly Federal Tax Return: <http://www.irs.gov/pub/irs-pdf/f941.pdf>

DC FR-900M, 2009 Employer's Withholding Tax Booklet - Monthly Returns and Annual Reconciliation: http://otr.cfo.dc.gov/otr/frames.asp?doc=/otr/lib/otr/2009_fr-900m_final.pdf

IRS Form 940: Employer's Annual Federal Unemployment (FUTA) Tax Return: <http://www.irs.gov/pub/irs-pdf/f940.pdf>

Individuals, Sole Proprietorships and Single-Member LLCs

IRS Form 1040, Schedule C, Profit or Loss from Business: <http://www.irs.gov/pub/irs-pdf/f1040sc.pdf>

IRS Form 1040, Schedule SE, Self-Employment Tax: <http://www.irs.gov/pub/irs-pdf/f1040sse.pdf>

Partnerships and entities taxed as partnerships

IRS Form 1065, U.S. Return of Partnership Income: <http://www.irs.gov/pub/irs-pdf/f1065.pdf>

IRS Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc.: <http://www.irs.gov/pub/irs-pdf/f1065sk1.pdf>

IRS Form 8832, Entity Classification Election: <http://www.irs.gov/pub/irs-pdf/f8832.pdf>

Personal Service Corporations

IRS Form 1120, U.S. Corporation Income Tax Return <http://www.irs.gov/pub/irs-pdf/f1120.pdf>