BENCH SMALL BUSINESS GUIDES

Small Business Accounting 101

A guide for new entrepreneurs

Intro-duction

Starting a business? Congratulations! You're taking on a huge task. Get ready for lots of exciting milestones and a to-do list that extends ad infinitum.

Deciding how to structure and manage your finances is one of the most important parts of your launch. How will you take payments? Where will you stash your cash? And what accounting practices will you leverage to make your money grow?

If you take the time to thoughtfully structure your small business accounting setup, you won't just find it easier to file your taxes each year. You'll save time, money, and stress. You'll have accurate financial statements on hand—useful documents that show you how your business is performing at any given moment. And it will be easier to work with a bookkeeper and an accountant, as well as any potential investors who come knocking when it's time for you to sell.

Follow the steps in this guide, and put your business on the path to longevity and financial success.

Chapter One

Hire a CPA

If you're serious about growing and (eventually) selling your business, you need to team up with a Certified Public Accountant (CPA) early on.

Beyond filing your tax return, an experienced CPA can help you with:

- Financial strategy
- Tax planning
- Tax compliance
- Lease negotiations
- Treasury management
- Financial reporting

A CPA can also help you make long-term, big picture decisions about the future of your business.

How to Hire the Right CPA

It's best to work with a CPA who has experience with clients in your industry. Ask other business owners in your niche for referrals. Once you have a few leads, contact them individually. Any CPA should be willing to sit down with you for a free consultation.

Discuss Rates Upfront

Be sure to discuss any prospective CPA's rates during the consultation. Most charge hourly, but some may ask for a monthly retainer.

Questions to Ask Your CPA

Once you've chosen an accountant to work with, use these questions to guide your initial conversation. Make sure you're clear on all of the accounting obligations related to managing and growing your business.

- What business expenses can I deduct?
- What is the best legal structure for my business?
- Do I need to register for a payroll service?
- Do I need payroll insurance?
- What other types of business insurance do I need?
- How does the legal structure of my business affect tax filing?
- What are my tax obligations?
- Do I have to collect sales tax?
- Does my business have a sales tax nexus in another state?
- What can I do throughout the year to reduce my tax bill?
- What records and paperwork do I need to keep on file?

Chapter Two

Open a Business Bank Account

Choose the Best Bank for Your Needs

When you're shopping around for a bank that offers small business bank accounts, remember: every business is different. The "right bank" for you will depend on the nature of your business and the way you prefer to get your banking done.

Here are some guiding questions to consider while you're comparing options:

- Is it okay if the bank is online only? Or will you need in-person access at a nearby branch?
- Does the bank play well with your Point of Sale (POS) system? (If you use one.)
- What does the bank offer in terms of security and fraud protection?
- Can they provide access to a line of credit?
- Does the bank's online banking option let you designate separate users (for business partners, if necessary)?
- What kind of fees are they going to charge you?
- Does the bank also offer business savings accounts, and business credit cards?

It's also a bonus if the bank proactively caters to small businesses. For example, some banks offer no-charge business checking accounts. Make sure you compare a few options—and take note of requirements such as maintaining a minimum balance—before settling on a bank.

“A business savings account is a good place to store money you’re setting aside for taxes and unforeseen emergencies.”

Open a Business Checking Account *and* a Business Savings Account

Once you've chosen a bank to work with, you'll want to open two accounts: a **business checking account**, and a **business savings account**.

Manage business revenue in your checking account, and set aside money you'll need at a later date (for emergencies, to pay taxes, etc.) in a savings account.

Even though interest rates on business accounts are traditionally pretty low, having a cash surplus in a business savings account can improve your likelihood of being approved for a loan. It's also a good place to store money you're setting aside for taxes and unforeseen emergencies.

Depending on your needs, opening a money market account for savings might be a smart move. It's a type of interest-bearing account that offers a higher yield than traditional business savings accounts (interest rates for money market accounts sit at an average of 0.11% nationally). The catch? You'll be required to maintain a higher minimum amount in the account, and have limited check-writing options.

To open any kind of business bank account, your business needs to be registered with the state in which you are operating, and have a registered business name. You'll also be be expected to have an Employer Identification Number (EIN).

Call ahead and ask what paperwork you need to bring to your initial appointment before meeting with a representative of the bank.


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Consider a Business Credit Card

Before we get into this, let's be clear: it's a bad idea to fund your business with credit cards. Credit card interest rates are unfavorable. And the amount of funding you can get from a credit card is not as high as a line of credit or a business loan.

However, if you are confident that you can strategically use a credit card to grow your business and pay off your bill in full each month, having a business credit card can be helpful.

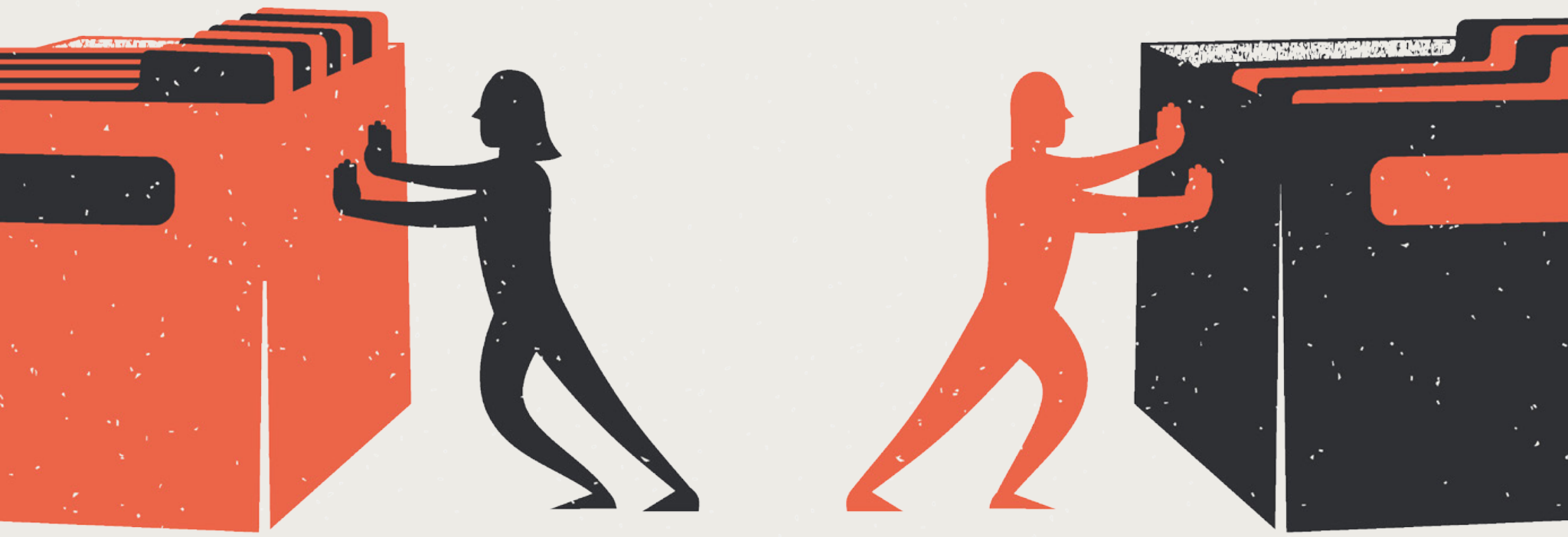
Smart use of a small business credit card can:

- Improve your business's credit rating over time
- Earn you benefits like cash-back rebates or travel points
- Give you access to fraud protection and additional warranty on purchases
- Give you an annual summary of your business expenditure, and help you stay organized

Get a breakdown of the cards available to you with Nerdwallet's Credit Card Comparison tool.

Chapter Three

Separate Your Finances



We can't stress this enough. Once your business bank accounts are up and running, **avoid mixing your personal and business finances**.

This means:

- Don't pay for a business expense using your personal bank card
- If your business is incorporated, don't transfer money from your business accounts to personal accounts

Granted, if your bookkeeper and accountant are on board with it, and you take care to flag transactions properly, using your business account for personal transactions (or vice versa) isn't the end of the world.

But mistakes can happen. Business expenses can get buried in personal bank accounts. And when you commingle your personal and business finances, the following problems can arise.

Your Accounting Will Become Overly Complicated

Managing all of your business transactions in a separate account makes it easier for you, your bookkeeper, and your CPA to manage your accounting. If everything is jumbled into one account, come tax time, you or your CPA will have to go through your bank records to figure out which expenses are related to your business. This will cost you time, money, and probably a few headaches.

You May Lose Money

When a business expense gets lost in your personal account and you don't claim it on your tax return, that's a tax deduction you're missing out on. And if your CPA has to spend time separating your personal expenses from your business expenses, you'll end up paying them more in accounting fees.

You May Lose Legal Protection

Have you ever heard of the "corporate veil"? It refers to the legal separation that exists between a corporation and its owners. In simpler terms, the corporate veil protects the owners of a corporation (and their personal assets) from any legal action taken against that corporation.

For instance, if your corporation was on the hook for a sum of money, the corporate veil would prevent you from being held personally liable for the debt. Instead, your corporation as an entity would be held liable.

Similarly, if your corporation happened to go bankrupt, the corporate veil would protect you from having to surrender personal funds or assets to repay the corporation's debt.

Courts will ignore this layer of legal protection if the corporate veil is pierced. One of the easiest ways to "pierce" the corporate veil is—you guessed it—mixing your personal and business expenses.

Corporations are legally required to maintain a separation between business assets, and the personal assets of the owners. Commingling your expenses removes the distinct separation between the corporation and its owners.

If the courts see that you've mixed your finances, they may disregard the protection of the corporate veil.

Chapter Four

Choose an Accounting Method

Small businesses can elect to use one of two accounting methods: **cash accounting** or **accrual accounting**.

You need to choose an accounting method before you file your first tax return, and then use it consistently on all subsequent returns.

The difference between the two is important to understand; your business's accounting method will affect cash flow, tax filing, and even how you do your bookkeeping.

Make sure to consult with a CPA before settling on the method you'll use.

Here's a basic overview of how each method works.

Cash Accounting

Cash accounting is commonly used by small businesses. It recognizes revenues when cash is received, and expenses when they are paid. This method does not recognize accounts receivable or accounts payable.

Many small businesses opt to use cash basis accounting because it's simple to maintain. The method makes it easy to determine when a transaction has occurred (the money is either in the bank or out of the bank) and there is no need to track receivables or payables.

The cash basis method is also beneficial in terms of tracking how much cash the business actually has at any given time; you can look at your bank balance and understand the resources you have at your disposal. (Minus outstanding checks or deposits in transit.)

Also, since transactions aren't recorded until the cash is received or paid, the business's income isn't taxed until it's in the bank.

> **Your business's accounting method will affect cash flow, tax filing, and even how you do your bookkeeping.**

Accrual Accounting

Accrual accounting records revenues and expenses when they are earned and incurred, regardless of when the money is actually received or paid.

The upside of this method is that it gives you a more realistic idea of income and expenses during a period of time.

The downside is that accrual accounting doesn't clearly indicate a business's true cash flow; a business using accrual accounting can appear to have money at its disposal, while in reality it has empty bank accounts.
To offset this risk, it's important to carefully monitor cash flow with accounts receivable (AR) and accounts payable (AP), which appear on your balance sheets.

So, which method is right for you?

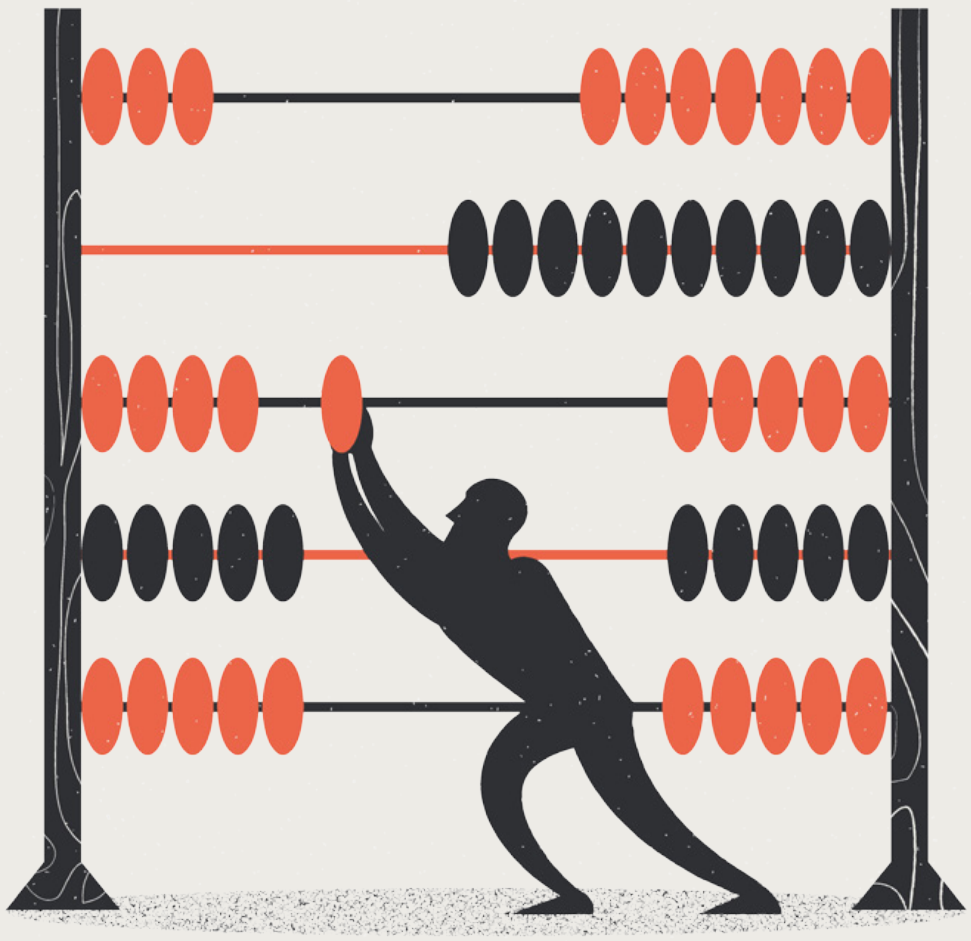
There's no easy answer to this question. Unless your business is legally required to use the accrual method, which method is best will depend on your accounting needs.

Also note that while you can technically change accounting methods, it's easier to pick the most advantageous method from the start and avoid switching down the line.

Ask a CPA to help you determine which accounting method is best for your business and stick with it.

Chapter Five

Develop a Bookkeeping System



For a CPA to work effectively, they will need you to provide accurate, up-to-date financial statements. This is where bookkeeping comes in.

Whether you're good with numbers and spreadsheets or not, every entrepreneur needs to understand the basic role that bookkeeping plays in a small business.

Bookkeeping is the process of recording daily transactions in a consistent way, and is a key component to building long-term financial success.

Bookkeeping is comprised of:

- Recording financial transactions
- Posting debits and credits
- Bank reconciliations
- Producing customer invoices and recording sales
- Receiving vendor invoices and recording expenses
- Maintaining and balancing subsidiaries, general ledgers, and historical accounts
- Completing payroll

The act of "bookkeeping" produces financial statements, which your CPA then uses to file your taxes and make strategic financial decisions that help your business grow.

Bookkeeping is an ongoing task which can be performed daily, weekly, or monthly. Whether you do the task yourself or outsource it to a pro, the goal is to make sure your books are accurate, up-to-date, and useful to you and your CPA.

Here are your options for getting your books done accurately and on-time:

- **Do It Yourself:** If you're up to the task, you can use spreadsheets or simple accounting software to manage your books. This method is great when you're just starting out and your bookkeeping isn't too complex.
- **Outsourced Bookkeeping:** When it makes sense for you to focus your time on other parts of your business, hand over your bookkeeping to a pro. An online bookkeeping service like Bench will give you a team of dedicated bookkeepers who do your books for you, and software to monitor your finances. Alternatively, you can hire a virtual bookkeeper online, or a local bookkeeper who works on a part-time or contract basis.

- **Hire an In-House Bookkeeper:** When your business is big enough to justify it, you can put a bookkeeper on payroll.

To choose the right bookkeeping method for your needs, consider the volume of bookkeeping you need to do, your budget, how much time you can devote to the task, and how confident you are in doing the books yourself.

Chapter Six

Master the Art of Recordkeeping

Everyone from your bookkeeper to your CPA and the IRS needs you to keep documents proving the income, credits, and deductions you put on your tax return.

That means you'll need to hold on to:

- Receipts
- Bank and credit card statements
- Bills
- Canceled checks
- Invoices
- Proof of payments
- Financial statements from Bench or your bookkeeper
- Previous tax returns
- W2 and 1099 forms

You should also keep any other documentary evidence that supports an item of income, a deduction, or credit shown on your tax return.

Each of these records should be kept for a specific length of time—some for 10 years, some for as few as three. You can learn more about record retention periods in our guide to small business recordkeeping.

The IRS doesn't require you to keep records of certain expenses under $75, but we still recommend that, to be safe, you keep digital copies of all records. The IRS accepts digital copies of receipts, and apps and online services make it relatively easy to scan and save them.

Other Deductions to Track

The types of expenses you can deduct on your tax return will depend on the expenses you incur in the course of doing business.

Deductions commonly available to small businesses include:

- Meals and Entertainment
- Out of Town Business Travel
- Vehicle-Related Expenses
- Business Gifts
- Home Office Expenses

For a longer list, check out Small Business Tax Deductions and How to Claim Them.

Go Paperless

To make your expense tracking paper-free, we recommend Expensify. The app lets you capture receipts and vehicle mileage with your phone's camera and GPS, respectively.

Chapter Six

Determine How Your Business Will Get Paid

We've talked a lot about how to manage money once it's in your hands. But how will your business receive money from customers and clients? Not to schmuck out on this, but like so many aspects of small biz accounting: it all depends on the nature of your business.

A brick-and-mortar store, an online-only business, and a freelance contractor will each have different needs when it comes to getting paid. Below are four common methods that will help you get started.

Once you determine how your business will receive payments, you'll then need to choose a payment provider to work with.

Just like a regular bank, every payment provider will have a different fee structure. Before you commit, make sure you do the math to determine the impact a provider's fees will have on your bottom line.

In-Person Payments

Accepting payments in person? Odds are you'll need a Point of Sale (POS) system that works with a cash register and/or a credit card reader. To set this up, you will need to open a merchant account with your bank, which acts as an intermediary between your customer's card account and your business account.

Online Payments

Stripe is a leading online payment solution. If your online store is powered by Shopify, Shopify Payments allows you to take credit card payments directly without the need for a third-party payment provider.

Mobile Card Readers

Mobile card readers like Square are handy for taking payments while you're on the go. Food trucks, personal trainers, mobile massage therapists, and pop-up shops are just some of the businesses that benefit from mobile card readers. Fees can be high, so make sure you're getting a good deal. Generally, mobile card readers are a good choice if you don't expect to process a high volume of payments every day.

Automated Invoicing

If you're a contractor who works on a project basis, you probably don't need to worry about setting up a POS system. That said, you will spend a lot of your time invoicing your clients. So pick an invoicing solution that automates a bunch of the legwork.

Freshbooks lets you set up recurring invoices and record project expenses. The platform also lets your clients pay outstanding invoices online, using their credit card.

Chapter Seven

Set Up Payroll

If you're going to hire employees, you will need to set up payroll. Gusto is an online service that automates a lot of the work involved in managing payroll and employee benefits.

Before adding anyone to your payroll, make sure your workers are categorized correctly as either employees or independent contractors. Get this wrong, and you may be fined by the IRS.

You will also need to understand your obligations in regards to employment law and employment tax. This is especially important when it comes to paying mandatory disability or worker's compensation insurance. You can research this on your state government's website, and consult with your CPA.

Chapter Eight

Get Clear on Your Tax Obligations

Paying taxes is relatively straightforward—until you start a business.

Businesses need to pay several different kinds of taxes across all levels of government: federal, state, and local. And your business's tax obligations are determined by a variety of factors, including geographic location, legal structure, the services or products you provide, and how you conduct business.

Here are the taxes small businesses commonly need to deal with.

Income Tax

Your business will have to pay income tax on its profits. How your business pays income tax is determined by your business's legal structure.

The rules, in short:

- **If your business is registered (and taxed) as a C corporation, or an LLC filing as a C corporation**, you'll probably claim business income on your personal tax return. Dividends or distributions are taxed at personal tax rates of the people who receive them. Finally, the corporation itself is taxed on its income.
- **If your business is registered (and taxed) as an S corporation or partnership, or LLC filing as an S corporation or partnership**, you'll report your income on your personal tax return, and the business itself will not be taxed on the federal level.

In addition, if your business owes more than $1,000 in taxes during the year, you are expected to pay quarterly estimated taxes four times annually.

Your business may also be required to pay state taxes in both your home state (where your business is registered) and in any states where your business has nexus.

Employment Tax (Payroll Taxes)

If you have employees, you'll have to pay Federal Insurance Contributions Act (FICA). Federal insurance contributions consist of the social security and Medicare taxes you withhold from your employee's pay and match with your own contributions.

The Federal Unemployment Tax Act (FUTA) tax provides payments of unemployment compensation to workers who have lost their jobs. It is an employer-only paid tax. The FUTA tax rate is 6%, which taxes wages up to the first $7,000 earned by the employee during the year. Speak to your accountant to make sure you are correctly withholding this tax throughout your payrolls. Also ask if you are eligible to receive a tax credit for paying timely state unemployment taxes.

Self-Employment Tax

If you are self-employed, you will need to pay federal self-employment tax. This is essentially FICA and Medicare, only your payment covers both a withholding from your wage and the matching contribution from your company.

Sales Tax

Sales tax is fraught with rules and exceptions, so collecting and paying sales tax can be daunting at first.

If you're completely new to sales tax, here's a bullet-point primer:

1. Sales tax is governed at state level
2. The state where you pay sales tax determines which goods and services are taxed, and how
3. You only need to collect sales tax in states where you have "sales tax nexus"
4. Register for a sales tax permit before you begin collecting sales tax
5. Collect sales tax in all nexus states, on every channel that you conduct business

6. The sales tax rate you collect can be origin-based or destination-based

7. Depending on your state and jurisdiction, how often you file sales tax may depend on sales volume. This varies by state and jurisdiction.

8. Sales tax due dates vary by state

9. File a sales tax return even if you didn't collect any sales tax

10. Some states will give you a discount for filing and paying sales tax on time

For more, read our guide to sales tax basics.

Check for “Other” Tax Obligations

Your business’s tax obligations may extend beyond the above list.

And just when you think you’ve got it all figured out, future changes to your business—such as buying property, or hiring employees—can also change your tax obligations!

Work with your CPA to determine how you will meet your sales tax obligations before you do business.

You run your business.
We do your bookkeeping.

Bench is the online bookkeeping service that does your bookkeeping for you.

Each month, a team of professional bookkeepers gathers your data and turns it into accurate financial statements.

You also get smart software to help you monitor your finances and stay in control of cash flow.

Refer friends.
Get $150 and free bookkeeping

REFER A FRIEND