



Coleman & Associates

Fully Integrated Tax, Accounting & Financial Services

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Important Dates:

September 15

- Filing deadline for 2024 calendar-year S corporation and partnership tax returns on extension
- Due date for 3rd quarter installment of 2025 estimated income tax for individuals, calendar-year corporations, and calendar-year trusts & estates

October 15

- Filing deadline for extended 2024 individual and C corporation tax returns

From Sole Proprietor to S-Corp: Consider a Switch

As a freelancer or contractor, at some point you may wish to incorporate and be taxed as an S corporation. Here's a closer look at the process of becoming an S corporation and when switching might make sense for you.

The main benefits of S corporations

- ✓ **Self-employment tax savings.** As a sole proprietor, you're required to pay a 15.3% self-employment tax (which includes Social Security and Medicare) on your entire income. However, with an S corporation, you can split your income into two parts: a reasonable salary (which is subject to self-employment taxes) and distributions (which are subject to income taxes but not self-employment taxes).
- ✓ **Pass-through taxation.** Similar to sole proprietorships, S corporations are considered pass-through entities. This means that the business itself doesn't pay income taxes. Instead, profits and losses pass through the business to the owner's personal tax return. Profits of a C corporation, on the other hand, are taxed twice – once at the entity level, and again on the owner's tax return.
- ✓ **Legal protection.** If there is a risk of possible legal action, an S corporation can potentially help protect your personal assets from your business assets. For example, this can be especially helpful if you are in the contractor trade and the customer makes a claim against the fulfillment of your contract.

While transitioning from a sole proprietor to an S corporation can certainly result in significant tax savings, there are a few trade-offs to consider.

Trade-offs to consider

Most of the trade-offs are centered around administrative requirements and potential costs. These include:

- **Running payroll.** Even if you're the only employee, you'll need to set up payroll and withhold taxes. Many business owners use a payroll service to handle this.
- **Separate tax filing.** Your business will now need to file a Form 1120-S tax return with a March 15th due date in addition to your personal tax return.
- **Accountants or bookkeepers are typically used.** Most S corporation owners work with professionals to handle bookkeeping and tax filings.
- **Reasonable salary requirement.** The IRS expects owners to pay themselves a fair market wage. Underpaying yourself to avoid taxes can lead to penalties.
- **State-level requirements.** Some states have minimum franchise taxes or annual fees for corporations and LLCs, regardless of income.

When it makes sense to switch

Switching to an S corp generally becomes worth considering when your net income (after expenses) is in the range of \$75,000 to \$100,000 or more per year.

Here's an example:

Assume you earn \$120,000 in net income as a consultant.

- ✚ *As a sole proprietor, you'd pay self-employment tax on the full amount, about \$18,000.*
- ✚ *As an S corp, if you pay yourself a reasonable salary of \$60,000, you'd only pay payroll taxes on that amount, roughly \$9,200. The remaining \$60,000 in profit would be subject to income taxes but not payroll taxes.*

That's a potential tax savings of nearly \$9,000 per year.

Switching from a sole proprietor to S corp can offer real tax advantages, but it's not a one-size-fits-all solution. It's usually best practice to review your situation once per year to ensure your business is organized properly.

Family Teamwork: A Smooth Transition Through the Ages

As you get older, so do your parents and grandparents. And at some point, the need for support and transition becomes unavoidable. If you're lucky, the shift happens gradually. But without planning, it can arrive suddenly and feel overwhelming. Here are some suggestions to make the transition smoother for everyone involved.

Parents (or grandparents!) – Proactively plan

Talking to your children or grandchildren about money, health, and living arrangements are not normally addressed. Your goal is to be prepared should you be faced with an emergency. This way you can avoid making key decisions in emergencies, such as in the ER, after a fall, or under emotional strain.

What you can do:

- **Make it legal.** If you have not already done so, set up a will, power of attorney, and healthcare directive. Most states have a preferred legal format that is often accompanied with a list of questions. Walk through this document with your children, and while it may seem awkward, remember they may need to be the one carrying out your wishes. Without these, your children may face expensive and drawn-out legal battles just to act on your behalf.
- **Share your financial picture.** Start small. It may be as simple as providing a place to get a list of your accounts and passwords if needed. Your children don't need every detail, but they need enough to understand resources, debts, and insurance coverage.
- **Clarify wishes for care.** Do you want to age in place? Would you consider assisted living? Who do you trust to make medical decisions if you can't? What funeral arrangements make sense?

Children – Initiate conversations sooner rather than later

This isn't about taking control from your parents, but rather it's about being ready to help when it's needed. Ideally your parents are having these conversations with you periodically, but if not you may find that you need to step into this void.

How you can help:

- **Learn their wishes now.** Ask where they'd like to live if living alone becomes unsafe, and what kind of care they would like. Or explore a plan to stay in their house, if that's their wish. Who knows, they may already have a robust plan in place, but then you'll know!
- **Understand available resources.** Know which bank accounts, insurance policies, and retirement funds exist, and where to find documents. Also get a general feel if there are adequate funds in place to navigate the next phase of life.
- **Build your own plan.** Prepare financially and emotionally for the possibility that you may need to help cover costs or coordinate care.
- **Become a resource.** Pay attention to changes in laws, then relay this information to your parents. An example is the extra \$6,000 senior deduction passed into law in July. By staying alert, you can ensure your parents are taking full advantage of the opportunities made available to them.

Know the tax tools available

Money is often the biggest stress point in transitioning to new living arrangements or higher levels of care. But many families overlook the tax credits, deductions, and programs that can ease the financial burden. Here are some key areas to explore:

- **Medical Expense Deductions.** If medical and long-term care expenses exceed 7.5% of your income, they may be deductible, including in-home care, assisted living (if medically necessary), and medical equipment.
- **Dependent Care Credit.** You may qualify for this credit if you pay for the care for a dependent parent while working.
- **Claiming a Parent as a Dependent.** If you provide more than half of your parent's support, you might be able to claim them as a dependent, which can further reduce your taxable income.
- **State-Specific Credits.** Some states offer tax breaks for care giving or senior housing. Check your state's tax agency for details.
- **Health Savings Accounts.** These accounts can be used tax-free for qualifying medical expenses for your parents if they're considered dependents, even if they're not on your insurance.

Get started today

The problem isn't that children and parents don't care about transition planning...it's that they think there's plenty of time to do it. Unfortunately, this is not always the case. Here's how you can start taking action today:

- **Schedule a first meeting.** Don't wait for the right moment. Put it on the calendar.
- **Break it into small pieces.** Talk about housing one week, finances the next. Avoid trying to solve everything at once.
- **Document agreements.** Even informal notes can be a lifesaver later.
- **Review regularly.** Life changes. So should the plan.

If handled properly, these planning discussions build a level of trust and create a level of partnership. The sooner you start talking and planning, the more control you'll have over choices, costs, and comfort.

The Truth Behind Common Tax Myths

Tax myths can spread quickly, leading to costly mistakes or missed opportunities. Here are several common tax myths along with best practices to help you stay grounded in reality.

Myth: Moving into a higher tax bracket means that's your total tax rate

Reality: The U.S. tax system is progressive, meaning your income is taxed in layers. There are currently 7 different layers, with tax rates ranging from 10% to 37%. When you enter a higher tax bracket, only the portion of income above the bracket threshold gets taxed at the higher rate, not your entire income.

Best Practice: *Know your marginal tax rate! This is the tax rate of the next dollar you earn. By understanding this you can do your own calculations on the impact of any additional income you earn.*

Myth: Getting a tax refund means you did something right.

Reality: A tax refund means you overpaid your taxes. It's your money, coming back to you – without interest. Getting a big refund might feel great, but from a cash flow perspective, you're better off adjusting your withholding so you keep more of your paycheck each month.

Best Practice: Review last year's tax return, then update the numbers to reflect your situation for the current year. Factor in the latest changes such as tax-free tips, tax-free overtime, and increased standard deductions, including the new \$6,000 deduction for seniors. Once you've made these adjustments, revisit your paycheck withholdings to make sure they're on track.

Myth: You can deduct all your expenses if you're self-employed.

Reality: Not quite. While being self-employed certainly opens up more deduction opportunities, not every expense qualifies. Only ordinary and necessary business expenses can be deducted. That family trip overseas doesn't qualify unless it was genuinely work-related (and even then, only parts of it might qualify).

Best Practice: Set up a dedicated business bank account to handle all income and expenses related to your work. Then establish a regular schedule to transfer funds into your personal account for all non-business spending. Don't commingle funds with your personal expenses. The IRS may be quick to throw out ALL expenses if they see this occurring.

Myth: You don't have to report income if you didn't receive a Form 1099.

Reality: If you earn money, the IRS expects you to report it, regardless of whether you received a Form 1099. Many people assume that if a client or gig platform doesn't send you a 1099, then that income doesn't need to be reported on your tax return. But that's not how it works. The tax code requires you to report all income, no matter how it's documented – or if it's not documented at all.

Best Practice: Keep a list of past 1099s to help you remember which clients or platforms have paid you before, and to double-check if you earned income from them again this year. Please call if you have any questions about your tax situation.

Beyond Your Credit Score: What Really Reflects Your Financial Health

A credit score is often treated like a financial grade. It's the number people look at when you are applying for a loan, renting an apartment, or even getting a job. But while it's important in certain situations, it doesn't tell the full story of your financial health. In fact, it misses some of the most important pieces.

What a credit score really measures

Your credit score is primarily designed to help lenders assess how likely you are to repay borrowed money. It looks at factors like your payment history, credit utilization, length of credit history, types of credit, and recent credit inquiries. In other words, it's a tool for measuring how you manage debt, not how you manage money overall.

You can have an excellent credit score and still struggle financially. You can also have a lower credit score and be in a strong financial position because you avoid using credit altogether.

What really matters for financial health

If your goal is long-term financial stability and peace of mind, there are more meaningful metrics than your credit score. Here's what you should pay attention to:

- ❖ **Cash flow mastery.** This is the foundation of your finances. Are you consistently spending less than you earn? Positive cash flow gives you the flexibility to save, invest, and plan for the future. Even if your income isn't high, managing it wisely can make a big difference.
- ❖ **Emergency readiness.** An emergency fund helps protect you from unexpected events such as a job loss, medical expenses, and home repairs. Having three to six months of living expenses saved can prevent you from going into debt during a crisis.
- ❖ **Debt load and structure.** How much you owe, and what kind of debt it is, plays a major role in your financial health. High-interest consumer debt, such as credit card balances, can be a major drain. On the other hand, low-interest, long-term debt (like a mortgage or student loan) may be more manageable.
- ❖ **Savings and investments.** Building wealth takes time and consistency. Regular saving, even in small amounts, can have a big impact. A credit score doesn't measure this, but your future self will.
- ❖ **Financial knowledge.** Understanding how your money works is essential, such as knowing how interest compounds, how taxes affect your income, and knowing how to set financial goals. You don't need to be an expert, but increasing your financial literacy over time helps you make smarter decisions and avoid costly mistakes.
- ❖ **Confidence around money.** Financial health isn't just about numbers. It's also about how you feel. You might have a great credit score but still feel anxious every time you check your bank account. Feeling stable and secure is a sign that your financial system is working for you.

Your credit score is just one small piece of the puzzle. It matters when you're borrowing money, but it's not a full measure of how well you're doing financially. Treat it like a tool – useful in the right context, but not the final word.

As always, contact the office with questions by emailing us at info@colemancpas.com or calling 773-444-3100. We are here to help.

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