EPISODE 1636

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FT: So Money episode 1636, last-minute tax mistakes you want to avoid, with Hannah Cole, Founder of Sunlight Tax.

> "**HC:** *What the IRS does, if you think about it, they have all the data from every single taxpayer. So what they do is they run basically like a score or a range for every single tax category in your business receipts, right? So they know that the average artist, writer, or performer spends between one and six percent on travel meals, spends maybe five percent on supplies. Every single category, they'll have some range. So what happens is if your spending in a particular category pops out of the average range, you will get a flag on your tax return."*

[INTRO]

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FT: Welcome back to So Money, everybody. I'm Farnoosh Torabi. Today, we're talking about some important steps for us, as we're all about to send in those tax filings. If you're a small business owner, it's really coming up, March 15th. So we're going to spend the next 30 minutes addressing some of the biggest mistakes that filers tend to make, and some of them can be quite costly.

Our guest is Hannah Cole. She's a tax expert who specializes in working with creative businesses and mission-driven solopreneurs. A longtime working artist herself, Hannah has helped tens of thousands of self-employed people skill up with accessible tax and money education. She has a money boot camp program, she offers speaking engagements, and she hosts the Sunlight Podcast. In our conversation, we get to the top mistakes that she sees clients make, how to reduce your chances for an audit this year, and the six figures, about 130k, that you may be leaving on the table if you delay contributing to your IRA before the annual deadline. Here's Hannah Cole.

[INTERVIEW]

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FT: Hannah Cole, welcome to So Money. You're now my go-to tax expert.

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HC: Ah, I love it. Thanks for having me. I'm thrilled.

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FT: What you do is so essential. Everyone's got to do their taxes. That's not negotiable.

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HC: Yes.

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FT: I mean, unless you want to pay the consequences. Yet this is not something that we're taught. It presents to be so complicated. How do you feel around tax season? It's a lot. Actually, this weekend, I have it on my calendar. I must dedicate time to getting my you know what in order.

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HC: Totally. I actually just this morning was organizing my own tax documents, and I was – it used to be – I mean, I almost got divorced over taxes. So I'm coming from a place of pain and experience. I understand what it is like to be disorganized and feel judged around this stuff. But I think February is an awesome time because all your tax documents should be in, even those brokerage statements which come a little bit later. They're usually out by the second week of February. Right about now is probably the earliest possible time that you could file your taxes.

If you do that early, it's got a lot of bonuses because you get your refund faster if you have a refund. You get better service from an accountant if you're working with one because it is their quietest month of all the months there are.

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FT: Really, February?

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HC: Yes. I know for the corporate tax return, so I know you were mentioning you have a corporate tax return, so those people who have an S corp or a partnership or a C corporation, that's pretty rare probably. But if you have a corporate tax return, one of those three, that's due March 15th. So as soon as you get into even late February, it's already getting to be where your accountant is a little crunched. Basically, if you can get your stuff in in early to mid-February, you just get better service.

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FT: Well, and then the thing is people do file extensions, so they are working all year on those taxes. I actually emailed you, this is a little behind the scenes, in a panic. It was like the last day of January, I think, or like two days before the last day of January. I think you're supposed to file your 1099s by the last day of January. I'm driving and I'm like, “I think I feel –” There’s a voice in my body that's like, “Farnoosh, you need to 1099 some folks,” that I had hired in 2023 for various – like the videographer that I hired for the event that I did, et cetera. Usually, I have a bookkeeper who takes care of all that stuff, but I ended up cutting ties with my bookkeeper in December. It's on me now, and I'm like, “What do I do?” I'm like, “I can probably figure this out, right? I'll just Google it.”

I went to the Google, and I got – I felt like I went down all these rabbit holes, and everything was – it would trick me. It was like a bait and switch. It was like I would do the 1099. I would fill it out. Then it was like, “Okay, you have to subscribe now for a year to our website in order to file this.” I was like, “I don't want to spend hundreds of dollars to do this. I feel like this is not the right site.” So I emailed you, and I emailed my CPA. Both of you came back with this brilliant site. I'll give it to everybody. It's called Track1099, Track1099. Use it. It was like a couple bucks, I think, to file.

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HC: I know. It’s safe. So cheap and so easy.

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FT: Basically nothing. Plus, it's also probably a tax write-off.

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HC: Totally. It is.

[00:06:04]

FT: All right, let's get this going. We're going to do a – I promise everyone a power 30 minutes of talking about taxes. Let's start with the number one hang-up you see a lot of people face this time of year which prevents them from either filing on time or filing correctly.

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HC: Yes. Well, I think the big hang-up is not understanding that your tax payment and your tax filing are separate. This is really, really important for you to understand because I think a lot of people wait to actually file their tax returns until April 15th. Or if you have a corporate return, that would be earlier. It would be March 14th because it's the 15th. They think they have to pay on the day that they file, but you don't. These two things are actually separate. You can file your tax return in February, and that's awesome because the filing of the tax return tells you how much you actually owe. But you still have two months to get the money together and also to do that sort of moving money from bank account to bank account, which anybody who's ever been scrambling on April 14th knows how stressful that is.

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FT: If you file an extension and you owe, you still owe on April 15th. That's the thing that I have had to learn the hard way.

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HC: Super, super important. People think that when they get an extension on their taxes, they think it extends the payment deadline, and it does not. Think of your payment deadline as immovable. It's April 15th and it does not change ever. If you file for an extension and you don't make a tax payment, you're supposed to estimate what you owe and pay it by the 15th. If you don't, you are accruing interest starting on April 16th, whether you have an extension or not. It doesn't matter. Filing and paying, they're two separate things. It's really good to have your brain straight about that.

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FT: Yes. Later on, I want to talk a little bit more about that extension process because I think that sometimes – I had a little bit of shame attached to that early on. Now, I have no shame. I'm like, “Oh, it's going to be –” I'm like, “I can already tell you we're going to be doing an extension.” Last year, I did a payment plan. I think it was last year for my taxes because it was so messed up. I had all this money due that I didn't anticipate, plus I was paying off some debt. I was like, “I need the liquidity.” I did a payment plan which I was like, “Oh, me, a financial expert.” It was the best thing I ever did. I loved it.

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HC: I’m so glad. I'm so glad.

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FT: Yes. I encourage this. If you need the space and the time and the liquidity to pay off, I think just do it. The IRS is not going to put handcuffs on you, and there's no shame, which is all what you do. You got into this space because you experienced a lot of shame around, as you mentioned earlier, the tax process and not knowing everything. I want to – you help a lot of creative people which is important because as creatives, we're told at least like, "Don't worry about money. Focus on the process. Focus on your creativity." Then we end up missing out a lot on the ease of how it is to manage your money and your taxes.

In your master class, one thing you want to talk about early on to folks is that there is something that a lot of us are doing which is a time waster and completely unnecessary. Can you tell us what that is?

[00:09:27]

HC: Yes. It's sorting your receipts. I see a lot of people. There's kind of a stereotype of the disorganized tax person who's got a shoe box full of receipts. Receipts are for deep storage. You actually really don't ever need to touch them, so long as you keep them. Think of them as they're there in case the IRS questions your deductions, right? They're there as the proof that the deduction you put on your tax return actually happened. PS, the sort of takeaway here is do not put things on your tax return you don't have a receipt for because the IRS has full authority to ask you to back it up at any time. You want that receipt in your storage, but you don't need to sort them.

Actually, I can give your listeners a little trick for keeping them in order. If you just take your receipts and every time – if you have – physical receipts are so rare these days. But when you do have them that I think for that reason they get lost even more quickly, just put them in the front of your wallet and just make that your habit. That's the only habit you need. They go in the front. Then, automatically, you're always going to have your receipts in a chronological order.

Then when your wallet is full and you want to dump the receipts, you have a dedicated file folder and you want to do it by year. You don't want to do seven years of receipts in one folder but a new folder each calendar year. Stick the receipts in the front of that folder. If you always know the most recent receipt is going to be in the front and then you dump it in the front of the folder, the whole folder will be organized according to date without you ever sorting anything. It’s like magic.

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FT: Brilliant. Can I take a picture of the receipt and that counts and I can throw away the physical copy?

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HC: Yes, that is fine. A digital copy of the receipt is fine, as long as all the information is visible. Actually, it's a good idea because I don't know if you've noticed, Farnoosh, but some of those receipts, the ink fades.

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FT: I'm going through your master class here a little bit, but I know you're leaving a lot more for people who do want to join, and it is free. I'll put the link, again, in the show notes. The top three mistakes freelancers make when settling up their money around tax season.

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HC: Well, one of the things that is a huge mistake that freelancers make is assuming that when they pay for a tax return that they – if you pay for a professional to do your taxes, that you get more than a tax return. That just, unfortunately, is not how it works. That's not how the industry is set up. When you pay for a tax return, you get a tax return. You don't get help generally calculating custom-estimated quarterly tax payment amounts. You don't get monthly support. You don't really even get tax planning or advising. It's kind of sad and unfortunate, but tax practices, and I say this as a person who has had one for a long time, they get so busy that they're just damming through as many tax returns as they possibly can. It's a volume business. If you're going to ask a lot of questions, if you want advice, they charge separately for that,

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FT: Yes.

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HC: That sounds like the voice of familiarity there, Farnoosh.

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FT: Yes. Well, if you read *A Healthy State of Panic*. Again, I don't know if I deleted this story. I might bring it back. If I did delete it, it begs putting it somewhere. I fired a CPA one year because he was so belligerent. I think we've talked about this the first time you were on my show. He was just so toxic.

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HC: We did.

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FT: He ended up going to jail.

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HC: I cannot believe that.

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FT: I know. I just had a spidey sense about him. I was like, “I don't think you're ethical.” Actually, when I left him, I had another CPA audit my taxes because I was like, “I want to get ahead of this. If there's some mistakes or I need to refile or whatever, I want to do this before I get in trouble.” Everything was fine because at the time, I was just in my late 20s. He was referred to me by a rich friend and I was – my office was upstairs from his office, so it was super convenient. Yes, I've been through the ringer with tax help, helpers.

Even now, when I have a great CPA, she charges us to do my taxes, my taxes with my husband. It’s a nice figure for her, but I do have her on – I have her accessible to me throughout the year. She's not telling me how to organize my taxes, but she is saying, “Here's what we should deduct from your payroll this year for your salary or this month for your salary.” It’s nice to have those eyes on my stuff.

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HC: For sure, for sure. Yes. Actually, since you're mentioning this corporate tax return, I'm guessing that you – I mean, I don't want to reveal things about your situation, Farnoosh. I don't actually know how you're organized, but my guess is that you're an S corporation.

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FT: I'm an S corporation. I use QuickBooks for all of my P&L, my balance sheet. I reconcile everything through there. I also use a payroll service to pay. I'm my only full-time employee, so it's really just for book recordkeeping to pay myself.

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HC: Actually, with S corporations, I just want to give people a warning because I have seen so much bad advice. Or people kind of go off half-cocked with them because they hear somebody be like, “Oh, my. You should be an S corp.” They don't actually do the background to know if it's going to benefit them financially. I see people form S corporations before it makes financial sense and end up paying a lot of money that they can't undo. I do a lot of consults with people, where we kind of sort out, like do some tax triage. So many of my calls are about people who got bad advice on S corps, so it's just like a real warning zone.

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FT: This is a big question in my community. I don't want to spend the whole episode on this because we could. I want to have you back to talk about S corps versus LLCs. So many people want to know what's the difference. I have friends who they have LLCs, and they have perfectly good businesses, and they run similar to mine. I'm like, “Should I have been an LLC?” I'd like to have you back, if you don't mind, for just that. I think that's a whole deep dive.

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HC: That would be a great deep dive. It will be very useful to people. It's a super confusing area.

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FT: I'm learning that of the three mistakes, one is that we don't have a system for receipts, which we think we have to also submit them. We don't. It's just more for like a backup in case we get audited, which later I want to find out what are the chances of getting audited and what are auditing red flags. But what are the other two mistakes that typically freelancers make with their taxes that you see?

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HC: Well, I think just not having a good system. One of the really big things is your bookkeeping and your taxes overlap by like 90% but not completely, not 100%. In that little 10% of non-overlap, that's basically where everybody's confusion is. This is a whole system that once you have a corporate tax return, an S corp, a partnership, you actually do this process called a book tax reconciliation. In other words, when you have a corporate formation, you actually have a process to sort out that little differential.

When you are a freelancer or self-employed person who files taxes just on their personal income tax return on a Schedule C, which is where self-employed people report their income, there is no reconciliation there. It becomes super confusing. It’s why that's the group that I specialize in because it's an area where people – they have all the complexity but not as much of the help. It could just be so confusing.

Some areas that don't overlap, just to illustrate my point here, there are things like your home office deduction, your mileage deduction. These are generally not tracked in your bookkeeping because they're items that you would generally be paying out of a personal account and not your business account. On your taxes, you get to sort of pull in a little piece of those personal expenses as a business expense. This is why it won't show up on your bookkeeping, but it will show up on your taxes.

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FT: Right. I long for the day where childcare can be a business expense.

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HC: Oh, gosh. Farnoosh, yes. Yes.

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FT: You know what I mean? I can't work if I don't have someone watching my kids, and I should be able to deduct for that. I'm just saying, Uncle Sam.

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HC: You know what's funny? The actual language of a business expense from the IRS is that it's ordinary and necessary. If you were a working parent, it feels so necessary to have childcare.

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FT: You know, there's the Child Tax Credit, and there's some credits for camp and childcare and all those. We would deduct as much as we could. Obviously, if you're employing someone, I think there's a little bit of a tax credit there, but no. By and large, there's not enough. I think that's one way for the government to say like, "Hey, families. We see you, we support you, and here's how we're going to do it. We're going to make your choice to –" Well, it's not really even a choice. You have to make money to support your family. A lot of us do have businesses or we're freelance. So it' be great if we could really maximize that child expense and optimize it for our taxes.

Okay, third thing that you want to really relay to freelancers because this is something that they're wasting their time on.

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HC: Other things that they're wasting their time on is really recalculating. When you track your deductions – by the way, I have a free visual guide for deductions that we can put a link in the show notes, but it's rainbow-colored and very pretty.

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FT: Okay, cool. You're an artist by trade, everybody. That's – this is really special. You're really –

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HC: That's real.

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FT: Two worlds. Sure.

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HC: It's kind of like I designed it kind of like a translator, so it's got what the human being will call it, what you think of the expense, and what you call it, in this column. Then over here – I know this is a podcast and I'm using a visual. But in the middle column, I write what the IRS calls it. It kind of maps what you call it to what the IRS calls it. Then it has the little rules.

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FT: Love it. Love it.

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HC: People can definitely download that if they go to the show notes.

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FT: I'm doing that.

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HC: Yes. One of the really frustrating things, when you've set up bookkeeping and you're tracking all those expenses and you have a dedicated business account, so you are doing your bookkeeping from your business bank statement, which is how you should do it, not from your receipts, which will make you feel crazy, people feel like, "I've set it up correctly. I've got my bookkeeping going. This is great." Then what happens is because the bookkeeping isn't tracking some of those differences between taxes and books, you end up at tax time freaking out and having to recalculate a bunch of categories. That can feel super, super frustrating.

Some of those categories are meals. Meals and also mileage because there are some things wherein the tax code, you're allowed to take the greater of one of two methods. The fact is if you haven't been tracking the method both ways for the whole year, you essentially have to go back through a year's worth of records and recalculate at tax time. I have kind of a method where I like to help people set up their bookkeeping to actually track those categories twice and then only pull in the bigger one into a formula which calculates what your taxes are.

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FT: Well, speaking of bookkeeping coming up this month, I think it's this month or maybe it's early March I have a guest on who is going to talk about her business which is the 5 Minute Bookkeeper.

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HC: Oh, that's awesome.

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FT: Five Minute Bookkeeper. That's like the seven-minute abs but better.

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HC: That’s amazing. Yes.

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FT: But it actually works and it's a lot more doable, so stay tuned for that. Now, you also talk about in your master class how to stash an extra $130,000 in your savings. I'm confused. I want to know all about this because I would like that. That sounds like a good deal.

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HC: Yes. It's a little bit my hang-up that I really want especially creative people who I think often discount the fact that they're ever going to be able to retire or save enough money to retire. I dedicate space in my master class every single time to showing people what the math of compound interest looks like over a career span and basically if you are investing. Hopefully, Farnoosh, this is your audience, right? This is like what you –

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FT: My language.

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HC: Why we listen here. If you're investing over your career span, I show the math with when you're investing using tax-advantaged accounts like an IRA, how much money your money earns in your last year. Basically, the mistake that people make is they put off funding their IRA. They're like, “Oh, I'll do it next year. It's not a big deal. I'll just wait a year.” But I actually show you the math that if you put it off for one year, it costs you $130,000 over the span of your career because that is how much money your money itself makes in its final year in there.

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FT: Yes. The maximum contribution this year, I think, is –

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HC: $6,500, unless you're over 50.

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FT: Right. Over 50 is catch-up contribution. We showed this in my investing master class in January, just how much $10 a day or funding your IRA in a year, where that will leave you, that one year's payment in the future. It's really powerful, and the math does not lie.

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HC: The math doesn't lie. I think a lot of us who either felt some aversion to numbers or we were creative and sort of told we were bad with money, which I find to be just not really true, ultimately. I think a lot of us just discount the fact that it's possible. It’s part of why I'm so dedicated to showing that math like, “No, no. Let's take a moment and look at this growth curve of your money.”

It’s kind of incredible how powerful compound interest is. If you are making eight percent annual return and, of course, your listeners will know that the stock market goes up and down. Eight percent is an average, not a guarantee. But if you're making eight percent, the compound interest, whatever amount you put in this year, it will double in nine years. Every nine years, your money will double. I mean, if you've done the math on doubling, you can see that it starts to form a curve where it goes up and up and up and up and up.

[00:25:23]

FT: Yes. I love it. It’s so good. Let’s go back to audits for a second. I promised we would talk about this. I read a statistic that said like, “Unless you're making a lot of money, unless you're in the one percent, you're probably not at risk of an audit.” But that being said, what do you see as some of the red flags that the IRS flags?

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HC: Yes. An audit is a checkup. It's not an accusation. It is the only check and balance in our tax system. All of us are subject to it any given year for anything in your tax return. When you're a business owner, a self-employed person, and you're tracking your business deductions, for example, one of the things to be aware of is you have a little code in the upper right corner of your Schedule C that identifies what field you're in. For me, as an artist, that's independent writer, performer, and artist. I don't know if you have the code writer or if you do something else, Farnoosh, but you might be in the same code as me.

Basically, what the IRS does, if you think about it, they have all the data from every single taxpayer. It’s the age of big data, and so what they do is they run basically like a score or a range for every single tax category in your business receipts, right? They know that every – the average artist, writer, or performer spends between one and six percent on travel meals, spends maybe five percent on supplies. Every single category, they'll have some range. So what happens is if your spending in a particular category pops out of the average range, you will get a flag on your tax return. A flag doesn't mean you will be audited. What it does mean is all audits come from flagged returns, so your odds go up.

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FT: Wow. Is there anywhere where I can see what the averages are so that I can always kind of –

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HC: Yes, you can.

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FT: Self-audit before I submit my taxes.

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HC: Yes, you can. I believe – I wish I remember what it stood for. It's called SOI. What you get flagged with is called a DIF score. It's something about the differential between yours and the average. If you were to Google around for SOI and DIF score, you would find it. Then you would put in your NAICS code, which is the little – I think it's a five or seven-digit code on the top of your tax return on your Schedule C or on your S corp return. Then you could see the range for that category. Yes, it's public data, so you can find it.

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FT: All right. Hannah Cole, thank you so much. It's never enough time to go over all the essentials with you. But really appreciate you and I definitely want to have you back to talk a little bit more about structuring your business, what's the most tax-beneficial. Good luck to everybody out there filing your taxes. I do have another episode coming up before that deadline to talk about bookkeeping. Send me your questions. We can dedicate Friday episodes to taxes.

Maybe we'll have Hannah back again before April 15th or March 15th. I don't know if we can squeeze it in, but you'll definitely be my go-to. You are my go-to.

Hannah Cole, thank you so much, of Sunlight Tax, everybody. We'll put the link to her master class in our show notes, too, her free master class. Thanks a lot.

[00:28:59]

HC: Awesome. We can put the link to that visual guide to business there too if you want that.

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FT: Oh, yes. I will be downloading that myself. Thank you.

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HC: Farnoosh, thank you so much. It's so lovely to talk to you. Good luck, everybody, filing your taxes.

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FT: Thanks, again, to Hannah Cole for stopping by. She is the Founder of Sunlight Tax. I've got links to all of her offers, including her free visual guide to your tax deductions and her podcast, Sunlight Tax, in our show notes. I'll see you back here on Wednesday, and I hope your day is So Money.

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