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Rookie Question on Getting Paid

Just recently, I got paid for the first time. When I got my cash up-front, I obviously deposited it into my IOLTA account. Now, all work is complete in the matter so I transferred the money into my Operating Account. When I did this though, a couple of questions popped into my mind. First, when you pay yourself like this, what do you do to make sure you're covered for
taxes? I'm used to having employers just take the money out each paycheck, but now that I'm on my own, this obviously isn't the case. Do you just set aside one-third for taxes or something like that every time you pay
yourself? Also, I understand that interest from IOLTA accounts has to be given to clients. In this case, no interest accrued on the funds. But let's say interest did accrue. How do I know whose funds generated the interest? I ask because there are funds from more than one client in my IOLTA account. Any light anyone could shed on this would be much appreciated. Thanks.

I believe that the interest in an IOLTA account goes to legal services department for your state. That is the whole point of IOLTA from my understanding... if you have a client that has a signficant amount of money for you to hold that will generate significant interest then you
are supposed to put that client's money in its own account separate from the IOLTA so that the client can keep the interest. At least that is the rule in TX from my understanding.

Joshua G. Jones, Texas

Congrats on your first payday as a Solo!
In California, the interest accrued on the IOLTA funds is automatically transferred by the bank to the State Bar. Not sure if it's the same in your state.

As for taxes, I used Quickbooks the first year to keep an eye on income / expenses, and tried to set aside 1/2 of the net profit, just to be safe. That worked out fine for me, but others have different (and probably better) methods of planning for taxes.

Brian Pedigo, California

If you have an actual "iolta" account set up at your bank, then the bank automatically takes the interest from your iolta account, and gives it to your state bar entity, thats why the statements should show no interest paid to
you in the iolta account.

As for taxes, you probably need to pay estimated quarterly taxes to the irs and the state. If you are disciplined enough to set aside 33% for taxes, good
for you! Most attorneys I know scramble every quarter or so to come up with their estimated payments to the Gov't. Hope and Change!

Michael A. Blake, Connecticut

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1. Taxes: are you operating as a sole proprietorship or as an entity like an S corp? If the former, you will need to make quarterly tax payments for any monies that are income to you. If the latter, you will need to decide how much to pay yourself as salary and how much will be a profit distribution. You will need to pay payroll taxes on any salary, and then quarterlies on any profit distributions. Check the archives -- there was some discussion recently as I recall about S corps and tax issues re: salary and profit distributions.

2. IOLTA: Check the rules in your state. At least here in California, interest on a general trust account (i.e. used generally for all clients) gets paid to the State Bar. The bank that sets up the account pays the interest directly so the attorney does not have to do so. We have the ability here to set up a specific trust account for a client (which sometimes is requested where a large sum of money will remain in trust for a lengthy period of time so there will be significant interest). I've never done it, but it seems you would just write a check out of the trust account to the client for the amount of interest.

Greg Goonan

What he said - same here in the GSOT.

Find yourself a banker, an actual person at a small, local bank. You will be treated impersonally at the mega outfits. Banker will know all about IOLTA accounts, will be able to refer you to CPA if needed plus help to get your name out. It's in banker's interest to help you make money.

Jimmy Verner, Texas

As a solo, you are self-employed. Hence, from now on you will file a Schedule C with your Form 1040, plus any other schedules that might apply. Taxes are supposed to be paid quarterly, via an estimated tax form. If you have employees, that's a whole 'nother subject...Forms 940 and 941 will soon be your next best friends.

As to your trust account, if it is an IOLTA, most of those accounts remit any interest earned to the state to help fund legal services for the indigent. That's how it works here; what happens in PA is not known to me. In a situation like that, any interest earned does not go to any client.

If PA does not have a program to help fund indigent legal services, why have an IOLTA? Unless you're carrying HUGE sums in there...which would earn interest that matters...just get a plain old no-interest earning trust account? No worries as to which client's fees earned which interest, etc. That could be an accounting nightmare.

Tom Simchak, Texas

As for the tax part... if you are self-employed, then you'll need to put some off to the side to cover taxes. If you are disciplined enough, you'll pay quarterly estimated taxes. But here's the fun part... all of that money you just put in your operating account... it's not all taxable income. You probably have some expenses you have to pay - rent, computer, software, bar dues, and the list goes on and on. So you get to reduce that check by these expenses (as long as they are allowed or not limited by the IRS)... until you get a significant amount of revenue (enough to cover all/majority your expenses), I probably wouldn't worry too much about it. Also know that you get to use all your personal deductions - like say mortgage interest and property taxes to help reduce it even more.

Bottom line... unless you really like taxes and dealing with such, get yourself a good CPA. They can really help you plan this stuff out. They can take, say your Quickbooks file or whatever you are using as internal books, and figure out if you are making a profit, such that you need to set aside money for taxes and tell you how to pay them. Oh, and a good one is also used to dealing with IOLTA accounts. To top it all off, they can be a good source of referrals to help your growing practice.

If you are making lots of money, don't forget about state and local (I think Philadelphia has a city tax) taxes too. You are probably used to those also being taken out of a paycheck. Not anymore.

Kimberly DeCarrera, Georgia

I agree with Kimberly, at least consult an accountant -- or a less expensive enrolled agent -- who can guide you through the taxes. When you can afford it, hire that person to help you with your books and taxes every month. And don't forget about your state taxes. In NM, we have a gross receipts tax on services which must be paid on the 25th of each month.

As for estimated tax payments to either state or feds, I believe, but I'm not 100% certain, that you don't HAVE to make those payments this first year of your business because the amounts of the estimated taxes are based on your last year's income which is zero for you. That said, you'll still need to set aside the money because the IRS will want it before April 15, 2010, but in 2009, I don't think you'll be penalized for not paying estimated tax payments this year.

Lynn Barnhill, New Mexico