

TRANSCRIPT

On Your Terms



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Episode #: 154

6 Mistakes to Avoid When Paying Yourself

Sam Vander Wielen:

Welcome back to On Your Terms. I'm your host, Sam Vander Wielen. I'm so excited to chat with you today all about paying yourself because this is such a popular topic on the podcast.

I have done a deep dive before in Episode 58 on how to pay yourself. So, if you haven't listened to Episode 58, I definitely recommend listening to it alongside this one or before this one, it doesn't really matter. But if you want to know exactly how to do it, Episode 58 is where it's at. But today, I wanted to talk with you all about some of the most common mistakes that I see when people try to pay themselves.

So, before we start talking about paying yourself, I have to share with you one of my favorite things. I always wait to test things out for a long time myself before I ever recommend anything to anybody. But I've been trying to like - okay, long story short. I would say since my parents have both died within a year of each other, which is rough, if you can imagine, I've had to really take supreme care of myself. And it's included a lot of things, like exercising, lifting weights, more both so that it gets me out of the house, but also because it's good for my body and it's creating community there.

I've also had to figure out a lot to do with sleep because I don't sleep well. Apparently when both of your parents die and it causes that much stress and sadness, it interrupts your sleep. So, I've had to do a lot around my sleep. And you know I love my coffee. And I don't necessarily drink a lot of coffee. I feel like that's a common misconception about me is that I drink a lot of coffee. It's just that I really, really like coffee, but I actually don't drink a ton of it.

So, one of the things I've been trying to do is give myself more time in the morning before I drink coffee, get some sunlight in my eye, kind of

like the Dr. Huberman effect or whatever. And then, when I do have coffee, I was interested in not overloading my system and spiking my cortisol.

So, I'm obsessed with these little coffee pods, capsule things from a company called Cometeer. Because I will literally try anything when it comes to coffee. Like, if there's some new technology, I'm so interested. So, my friend, Aaron, had told me about these Cometeer pods, they're like frozen capsules. So, you put them in the freezer and then you can thaw them in the fridge or you thaw them on the counter, and they're like flash frozen things of coffee that you just pour hot water over. Or if you're going to have ice, you just let it melt and then you have it over your ice or whatever.

And the reason I'm telling you is because they have a half-caf version of this. And so, I've been every morning doing my little routine, taking my time, having food first, doing all the things, and then I have a half-caf of Cometeer. So, I just wanted to mention that because if anybody here loves coffee, but maybe you're caffeine sensitive or trying to limit your caffeine. It's kind of cool because I'll have my cup of half-caf, and then if an hour later, I want a second cup, I have another half-caf. And I keep joking with Ryan like, "That's only one cup of coffee." So, it's just really convenient.

I'll drop a link down below to Cometeer because anybody who gets Cometeer gets a code to share with friends. You save money, I think I get something off maybe my next box or, I think, eventually they'll send me a mug or something, which would be really awesome. So, I love mugs and God knows I need another one. So, I'll share that down below. But I just thought I'd share that with you because I know so many of you are always interested in, like, caffeine related stuff and coffee and all that good stuff.

Okay. So, I did a deep dive on how to pay yourself in Episode 58, like I mentioned. But people can still make mistakes. So, even though in that episode I teach you how to pay yourself and kind of the thought process behind it, people still make mistakes when it comes to paying themselves, because we're human, you know, it's fine.

So, depending on which mistake you make that we're going to talk about today - there are at least six that I'm going to go over. I'm sure there are many, many more mistakes that we can all make, but I'm going to go over the six big ones - depending on which one you make, though, it can range from being a tax issue to something that just holds your business back and doesn't allow you to grow your business, to something that's penalizing yourself as a business owner when you shouldn't be, and just holding yourself back. Paying yourself can be really, really confusing, so I think it's best to just break down the confusion and the noise around it.

So, what is mistake number one? Okay. Mistake number one, I would say, when it comes to paying yourself, is that I see people pay themselves too much. Why is that a mistake? For many different reasons.

And you're going to hear me repeat myself a lot today, but I'm going to do it anyway, because I think sometimes it takes several times from several angles to really understand something. And this stuff is confusing. So, if you're confused and overwhelmed, let's take a deep breath together. It's okay to be confused and overwhelmed, and that's why you are going to hear me say things over and over from different angles.

So, paying yourself too much is a mistake because we need to have some money in reserves for many different things. So, we're going to use super basic examples today. If you make \$1,000, you have \$1,000 in your bank account, or whatever, and you pay yourself \$950, you're only leaving \$50 for your operating expenses to pay your taxes - like, even just to cover the taxes on the amount you just paid yourself because that's not tax deductible. We're going to think about that or we're going to talk about that in a sec - you're not leaving any room to build up capital. So, one of the mistakes I think people make in the beginning is paying themselves too much. They're taking too much out of the business.

I think that one of the things that really helped me to grow my business - yes, over the years. It didn't happen overnight. I'm not an overnight success story and that's fine. So, don't look to me if that's what you're looking for - to build it over years was that I was very focused on

building up my reserves. And those reserves are what helped me to capitalize when the moment was right.

So, when it comes to paying yourself, you want to make sure that whatever amount you're choosing to cut yourself a check from -you'll hear me talk about that in Episode 58 - is leaving enough in your account to cover many months of your operating expenses to build up some reserves in your business, and also to pay your taxes, and to give yourself some wiggle room to invest in some unexpected things. Like maybe you have enough to cover your expenses, but what happens when you decide you want to start a podcast and it's a few hundred dollars to buy some equipment, right? So, that's why we have reserves and we build up. So, we want to make sure that we're not paying ourselves too much.

Now, mistake number two, on the flip side, is that I see people paying themselves too little. Too little is not good because you're not going to be able to survive as a human without getting paid. I think we all know that.

But sometimes people will pay themselves so little and then say like, "I can't do this for long because it's not covering my bills." And I'm like, "Well, how much are you paying yourself?" "Well, I'm only paying myself \$200." It's like, "Why are you only paying yourself \$200?" So, unless that's what makes financial sense, based on what we just talked about in mistake number one, that's not a great balance either because you're not going to be able to sustain running a business for a long time if you're not able to live, obviously.

Now, just to combine mistake number one and mistake number two a little bit, because we just did a little bit of Goldilocks like, don't pay yourself too much, don't pay yourself too little. How much is right? That is so dependent. That is a really tough question to ask because, you know, it depends on how much you're making. So then, I would look at that balance of what's a comfortable number that I can pay myself, and then knowing that I have the expenses covered in my bank account, I have taxes covered in my bank account, and I have a little left over so I'm starting to build up some reserves in case I hit some tough times.

The way that I like to look at it is, when I was in the beginning, I was like, "How much could I pay myself consistently right now?" So, if you look at your account and this month you could pay yourself \$1,500, but then that might mean that next month you don't get paid, what if instead you paid yourself \$500 for the next three months? That's how I treated it in the beginning was I started seeing long term pattern. Like, I would love to take out more, don't get me wrong. I got to pay for my coffee subscriptions. But I saw what amount was okay for me over time. So, I think that that's helpful.

I think it's also helpful for budgeting purposes. Obviously, you should be going into this knowing how much do you need to make as a human. So, how much do you need to be pulling out of your business, that might mean that in the beginning you're not only relying on your business's income.

So, when I started my business, I knew how much I needed to live and there was no way my little baby business at that time was going to be able to do that for me, and I wasn't going to put that kind of pressure on it. So, instead, I hung on to an attorney job for an additional six months to bank up that amount of money so that I could pay myself over time because I knew that I wasn't going to be able to do it. I also started selling things. I was pitching in, like asking people if they needed help for the day and getting paid for a day's worth of work. I was doing all different kinds of stuff because I didn't want to put that pressure on my business.

So, I just wanted to mention that to you in case you're feeling that. I think it's something that people don't talk about that they had to do in the beginning. And I remember in the beginning I was paying myself very, very little, like a few hundred dollars or something per month, because I had saved up the money I had was working for my other job. So, my business didn't really need to supplement my income that much, what I needed to bring home.

And so, I then would look at my business long term and say, "Okay. Can I do \$500 for the next few months? Okay. Now, I'm seeing it's more comfortable, can I do \$1,000?" And then, eventually, it was \$2,000, and then \$3,000,

\$4,000, \$5,000, \$10,000, \$15,000, so it kept going. But I only shift when I can see that I can pay myself that consistently for a long time. And the way that I always do it, which is probably very conservative, is could I pay myself for this for however long if nothing new came in? I mean, I know I have my recurring revenue, but if I didn't make any additional sales.

Because then what I found was, over time, new sales always came in, the business always grew. If you continue to work hard and you have a good product and all that stuff, it continues to grow. And so, by doing that, I was just setting myself up for safe growth. And I think not pulling out too much from the business really made my business very healthy. And not pulling out too little, made me really healthy and made me keep going and I was seeing improvement and progress.

All right. Now, let's get back to our mistakes. Mistake number three is thinking that your payments to yourself are tax deductible or that they're business expenses. So, the amount that you pay yourself when you're just a single member LLC, you're not an S-Corp so that means you're not filing taxes as an S-Corp, you're just a regular old LLC, and you would know the difference because if you become an S-Corp, you're getting a paycheck and it's a totally different ball game, if you're just transferring money yourself or cutting yourself a check, what we call owner's draws, are not tax deductible.

What that means is that it does not reduce your taxable income of your business, so you still owe taxes on that money. So, that's why when you go to pay yourself \$1,000, for example, that \$1,000 is taxable. And so, we need to set aside. I'm just making up numbers because how much you get taxed depends on a lot of different factors. But the way you kind of have to think about it is like, paying yourself \$1,000 really costs \$1,200 or \$1,300 because of all the taxes that you have to pay on it. So, when you're transferring that money, it's almost like you need to make sure that there's \$1,300 available, not just the \$1,000 that you're actually paying yourself.

All right. Mistake number four is approaching paying yourself with a feast or famine attitude or mindset. So, this kind of goes back to mistake number

one and two, but I think that it can really hurt a business when you pay yourself way too much and then you're like, "Oh. I have to completely starve myself. I can't pay myself for the next several months." And then, you pay yourself too much, it's hard on cash flow. I think it's hard to budget. It's hard to get consistent. Once you bring somebody in to help you with your business, if I was taking huge swaths of money here and there, it's very hard to know that they have the consistency and that they can set up a budget.

So, it's really important, I think, that you don't have as much of this feast-famine mindset when it comes to paying yourself. But I think I've mentioned multiple times now throughout the episode of having more of this mindset of What can I do consistently? What can I do safely? And if you want to revisit that every two or three months, revisit every two or three months, maybe it can go up, that's okay. But I think consistency is better than the flip flopping.

Mistake number five is not marking the payments to yourself properly in your bookkeeping. So, this can happen when you have your accounts all mixed, or you're doing digital transfers, or you write a check to yourself, but you don't mark it. You should always be marking those as owner's draws or owner's pay, or whatever your bookkeeping software wants to do or if you have an accountant or a bookkeeper, obviously, you should follow their advice. But, generally speaking, you want to make sure it's always marked properly so that they understand what it is and it's going to also go on your personal income tax return.

Mistake number six, last but not least, is not reinvesting in the business and allowing some capital to build up. Because, honestly, that's a form of investing in yourself, too. That's how I always saw it. In the beginning, like I mentioned, I would not only make sure that there was enough revenue in my business bank account to cover my taxes and to cover all my expenses in the business, but also I was building up a little bit of an arsenal.

And I probably let mine build up too much. You don't need to build up that big of an arsenal, but I let it build up for so long because, obviously, I have my own safety and security issues with feeling okay and safe and

comfortable with money. And I wanted to feel super safe and secure. And now I could, you know, ride into the sunset.

You don't need to do that for that long. But I do recommend building up some sort of capital so that when you go to invest in a big project, like you want to get a website done, for example, or you want to hire an SEO expert, or you want to travel to the first couple of conferences and it's expensive to fly and stay and all of that, that's going to be super helpful.

I know for me, in case you're ever interested in ads, this is where it came really, really to be so beneficial when it came to ads. Because when I invested in Facebook Ads and Instagram Ads - I guess it was back in early 2021. I think it was like the month before COVID. I had really lucky timing - when I invested in Facebook Ads for the first time, I went into it with an experimenter's mindset. And so, I was able to say like, "You know what? I'm going into this." I was so nervous to spend that much money. My ad management fee is expensive. I started out paying very little, maybe \$2,000 to \$5,000 or something, in ad spend, which for me at the time felt like \$1 million.

And so, I started doing that and all of that, but I knew that I wanted to commit to it for several months because it takes time for them to kick in. And I knew that if they didn't work out, that it was an experiment. And, yes, it would sting and all of that, but it wouldn't sink my business. So, I really recommend, you know, building up some sort of capital. Obviously, capital is all relative as you're building.

In the beginning, my capital was a few hundred dollars and a few thousand dollars and tens of and then hundreds of, so it's different as your business continues to grow and you've got to start somewhere. And I want you to think of pennies that you're depositing over time are going to add up to many, many dollars. So, it might not feel like a lot right now, but you got to chip away and continue to save that up.

So, if you were to take away three things from this episode, I would say is that, one, you have to listen to Episode 58 if you haven't already because

you want to learn how to properly pay yourself so you're not getting in any legal trouble or anything like that. The second thing is that I think you probably realized that there's a bit of a balance here of not paying yourself too much and not too little. And the third is this idea that it is not tax deductible. So, therefore, you have to be really conscientious when you're transferring the money that you have enough to pay taxes on it, and you're building up that little arsenal of capital, and we have enough to pay our taxes and enough to pay our expenses. And, therefore, we feel good and safe and protected.

So, I hope that this was helpful today talking about some of the biggest mistakes that people make when they're paying themselves. If you think this would be helpful for one of your friends or a colleague, if you could text it to them really quickly, that would be so helpful. Please follow and subscribe to the show. Wherever you listen, leave a quick rating or review if you have time. And I'll make sure I drop all of the resources that I mentioned today, including Episode 58, in the show notes below. Thanks so much for listening. I'll see you next week.

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