



# Business Recordkeeping

Everyone in business must keep records. Keeping good records is very important to your business. Good records will help you do the following:

- Monitor the progress of your business
- Prepare your financial statements
- Identify source of receipts
- Keep track of deductible expenses
- Prepare your tax returns
- Support items reported on tax returns

## **Monitor the progress of your business**

You need good records to monitor the progress of your business. Records can show whether your business is improving, which items are selling, or what changes you need to make. Good records can increase the likelihood of business success.

## **Prepare your financial statements**

You need good records to prepare accurate financial statements. These include income (profit and loss) statements and balance sheets. These statements can help you in dealing with your bank or creditors and help you manage your business.

- An **income statement** shows the income and expenses of the business for a given period of time.
- A **balance sheet** shows the assets, liabilities, and your equity in the business on a given date.

## **Identify source of receipts**

You will receive money or property from many sources. Your records can identify the source of your receipts. You need this information to separate business from nonbusiness receipts and taxable from nontaxable income.

## **Keep track of deductible expenses**

You may forget expenses when you prepare your tax return, unless you record them when they occur.

## **Prepare your tax return**

You need good records to prepare your tax returns. These records must support the income, expenses, and credits you report. Generally, these are the same records you use to monitor your business and prepare your financial statement.



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## Support items reported on tax returns

You must keep your business records available at all times for inspection by the IRS. If the IRS examines any of your tax returns, you may be asked to explain the items reported. A complete set of records will speed up the examination.

You may choose any recordkeeping system suited to your business that clearly shows your income and expenses. Except in a few cases, the law does not require any special kind of records. However, the business you are in affects the type of records you need to keep for federal tax purposes. Your recordkeeping system should also include a summary of your business transactions. This summary is ordinarily made in your business books (for example, accounting journals and ledgers). Your books must show your gross income, as well as your deductions and credits. For most small businesses, the business checkbook is the main source for entries in the business books.

## Supporting Business Documents

Purchases, sales, payroll, and other transactions you have in your business will generate supporting documents such as invoices and receipts. Supporting documents include sales slips, paid bills, invoices, receipts, deposit slips, and canceled checks. These documents contain the information you need to record in your books. It is important to keep these documents because they support the entries in your books and on your tax return. You should keep them in an orderly fashion and in a safe place. For instance, organize them by year and type of income or expense.

*The following are some of the types of records you should keep:*

- **Gross receipts** are the income you receive from your business. You should keep supporting documents that show the amounts and sources of your gross receipts. Documents for gross receipts include the following:
  - Cash register tapes
  - Bank deposit slips
  - Receipt books
  - Invoices
  - Credit card charge slips
  - Forms 1099-MISC



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- **Purchases** are the items you buy and resell to customers. If you are a manufacturer or producer, this includes the cost of all raw materials or parts purchased for manufacture into finished products. Your supporting documents should show the amount paid and that the amount was for purchases. Documents for purchases include the following:
  - Canceled checks
  - Cash register tape receipts
  - Credit card sales slips
  - Invoices
  
- **Expenses** are the costs you incur (other than purchases) to carry on your business. Your supporting documents should show the amount paid and that the amount was for a business expense. Documents for expenses include the following:
  - Canceled checks
  - Cash register tapes
  - Account statements
  - Credit card sales slips
  - Invoices
  - Petty cash slips for small cash payments
  
- **Travel, Transportation, Entertainment, and Gift Expenses**  
If you deduct travel, entertainment, gift or transportation expenses, you must be able to prove (substantiate) certain elements of expenses. (See attached table 5-1)



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Table 5-1. How to Prove Certain Business Expenses For Travel & Entertainment

If you have expenses for . . .	THEN you must keep records that show details of the following elements . . . (must have physical RECEIPTS).			
	Amount	Time	Place or Description	Business Purpose Business Relationship
<b>Travel</b>	Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, fees and tips, etc.	Dates you left and returned for each trip and number of days spent on business.	Destination or area of your travel (name of city, town, or other designation).	<p><u>Purpose:</u> Business purpose for the expense or the business benefit gained or expected to be gained.</p> <p><u>Relationship:</u> N/A</p>
<b>Entertainment</b>	Cost of each separate expense. Incidental expenses such as taxis, telephones, etc., may be totaled on a daily basis.	Date of entertainment. (Also see <i>Business Purpose</i> .)	Name and address or location of place of entertainment. Type of entertainment if not otherwise apparent. (Also see <i>Business Purpose</i> .)	<p><u>Purpose:</u> Business purpose for the expense or the business benefit gained or expected to be gained. For entertainment, the nature of the business discussion or activity. If the entertainment was directly before or after a business discussion: the date, place, nature, and duration of the business discussion, and the identities of the persons who took part in both the business discussion and the entertainment activity.</p> <p><u>Relationship:</u> Occupations or other information (such as</p>



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If you have expenses for . . .	THEN you must keep records that show details of the following elements . . . (must have physical RECEIPTS).			
	Amount	Time	Place or Description	Business Purpose Business Relationship
				names, titles, or other designations) about the recipients that shows their business relationship to you. For entertainment, you must also prove that you or your employee was present if the entertainment was a business meal.
<b>Gifts</b>	Cost of the gift.	Date of the gift.	Description of the gift.	
<b>Transportation</b>	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses, the date of the use of the car.	Your business destination.	<u>Purpose:</u> Business purpose for the expense. <u>Relationship:</u> N/A

- The use of your car for business purposes. Invoices of deliveries establish when you used the car for business.



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**Table 1-1. Travel Expenses You Can Deduct**

IF you have expenses for...	This chart summarizes expenses you can deduct when you travel away from home for business purposes. <b>THEN you can deduct the cost of...</b>
transportation	travel by airplane, train, bus, or car between your home and your business destination. If you were provided with a ticket or you are riding free as a result of a frequent traveler or similar program, your cost is zero. If you travel by ship, see <a href="#">Luxury Water Travel</a> and <a href="#">Cruise Ships</a> (under <i>Conventions</i> ) for additional rules and limits.
taxi, commuter bus, and airport limousine	fares for these and other types of transportation that take you between: <ul style="list-style-type: none"> <li>• The airport or station and your hotel, and</li> <li>• The hotel and the work location of your customers or clients, your business meeting place, or your temporary work location.</li> </ul>
baggage and shipping	sending baggage and sample or display material between your regular and temporary work locations.
car	operating and maintaining your car when traveling away from home on business. You can deduct actual expenses or the standard mileage rate, as well as business-related tolls and parking. If you rent a car while away from home on business, you can deduct only the business-use portion of the expenses.
lodging and meals	your lodging and meals if your business trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. Meals include amounts spent for food, beverages, taxes, and related tips. See <a href="#">Meals</a> for additional rules and limits.
cleaning	dry cleaning and laundry.
telephone	business calls while on your business trip. This includes business communication by fax machine or other communication devices.
tips	tips you pay for any expenses in this chart.
other	other similar ordinary and necessary expenses related to your business travel. These expenses might include transportation to or from a business meal, public stenographer's fees, computer rental fees, and operating and maintaining a house trailer.



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- **Assets** are the property, such as machinery and furniture, that you own and use in your business. You must keep records to verify certain information about your business assets. You need records to compute the annual depreciation and the gain or loss when you sell the assets. Documents for assets include the following:
  - When and how you acquired the assets.
  - Purchase price
  - Cost of any improvements.
  - Section 179 deduction taken.
  - Deductions taken for depreciation.
  - Deductions taken for casualty losses, such as losses resulting from fires or storms.
  - How you used the asset.
  - When and how you disposed of the asset.
  - Selling price.
  - Expenses of sale.

The following documents may show this information.

- Purchase and sales invoices.
- Real estate closing statements.
- Canceled checks.

## Employers

Keep all records of employment taxes for at least four years after filing the 4th quarter for the year. These should be available for IRS review. Records should include:

- Your employer identification number.
- Amounts and dates of all wage, annuity, and pension payments.
- Amounts of tips reported.
- The fair market value of in-kind wages paid.
- Names, addresses, social security numbers, and occupations of employees and recipients.
- Any employee copies of Form W-2 that were returned to you as undeliverable.
- Dates of employment.



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- Periods for which employees and recipients were paid while absent due to sickness or injury and the amount and weekly rate of payments you or third-party payers made to them.
- Copies of employees' and recipients' income tax withholding allowance certificates (Forms W-4, W-4P, W-4S, and W-4V).
- Dates and amounts of tax deposits you made.
- Copies of returns filed.
- Records of allocated tips.
- Records of fringe benefits provided, including substantiation.

## NOTE\*

*Tax preparers must verify all deductions and expenses in order to put them on a tax return; estimations or approximations are not allowed. Additionally, they have implemented heavy legal penalties and fines for both the client and the tax preparer for inaccurate information submitted.*

*~Tax return preparers are also subject to criminal sanctions arising from improper conduct. For example, a tax return preparer that helps taxpayers prepare false or fraudulent returns may be liable and could receive a prison term and a fine of up to \$100,000 under sections 7206 and 7207.*

*~By willfully providing the IRS with fraudulent information on a tax return, it is considered taking part in a potentially criminal penalty situation. Depending upon the severity of the fraudulent information, penalties can include facing court dates, restitution, and possible imprisonment.*

*In a situation involving your tax return containing any underpayment of tax due to fraud, the IRS will penalize a hefty 75% of the underpayment tax amount due.*

***\*\*You must be able to prove all items on your return with adequate records or sufficient evidence and must be present at time of tax return preparation.\*\****