

Tax Tips

.....

A NEWSLETTER FOR NEW BUSINESSES

courtesy of

The Internal Revenue
Service

.....

IRS Tax Assistance Telephone Numbers

1-800-829-1040
for general tax assistance

1-800-829-4477
TeleTax
for recorded tax information

1-800-829-3676
for FREE
tax forms and publications

Claiming Your Business Expenses

Don't Get Personal!

When you figure out the tax your business will be paying this year, one of your most important tasks will be to make sure you claim all the business expense deductions you are entitled to. Reducing your taxable income through business deductions means you'll owe less tax, and there is no reason to pay more tax than the law requires.

But what business deductions can you take? Most of them are obvious enough. But what about all those gray areas, situations where your business and personal expenses intertwine, where family responsibilities and business duties run up bills simultaneously?

Let's look at the basic rules covering business expenses. To be deductible, a business expense has to be what the tax law calls an "ordinary and necessary" expenditure. An ordinary expense is one that is generally accepted in your particular line of business.

A necessary expense is one that is helpful and appropriate to your business. That rules out any expenses that are strictly personal in nature.

These definitions highlight a major problem for some smaller businesses. Many people who run their own one-person business never bother to set up a business book-keeping system separate from their personal one. Their checking account serves as both a personal and a business account.

Money is co-mingled in their accounts, and it may be impossible to distinguish business expenses from personal ones.

If that describes your situation, you need to act now. Most professional tax consultants recommend that you open a separate business bank account. Your bank may charge you an extra fee, but the new account will more than pay for itself in accounting efficiency alone.

Let's look at some specific expenses to see the best way to sort out the personal from the business-related.

Cars offer a graphic example of something that can easily cross over from one part of your life to the other. You can only deduct expenses for the business use of your car as a business expense. If you use your car for both business and personal reasons, you must be able to show the details of all business-related use: when you made the trip, how far you went and the exact business purpose of the trip.

To do this, you need a log book or calendar to record car usage. Show all of the necessary information about why and when you use the car, and write it down at the time you actually make the trip. It's important to record the business mileage at the time you made the trip. If you are claiming only a part of the car's use as a business deduction, you must be able to show that your business use was a reasonable percentage of the total.

The business use of your home is another major intersection between your business and personal lives. There are a number of very specific tests your business use must pass before it can be considered tax deductible. Among other things, you must show that the business area of your house is never used for personal purposes. (continued on page 2)

You divide your home expenses, between your personal area and your qualifying business area, either by the number of rooms or by square footage. For example, if you use one room in a six-room house for business, then one-sixth of your home expenses may be business-related.

Business travel and entertainment can present an even less clear-cut division between what's personal and what's business. Claiming a business deduction is a matter of proving conclusively that the travel or entertainment was primarily business related.

Problem areas can include out-of-town conventions featuring considerable non-business activity and many kinds of entertainment and the cost of extremely luxurious hotel accommodations. The IRS is likely to view these as personal expenses and require clear proof of the portion of the expenses that will meet the ordinary and necessary tests.

Another common pitfall is the personal use of items from your business. Keep track of anything you take from your business for your own personal use, and make sure it is not included in your business inventory.

In all of these areas, solid record-keeping is the key to claiming your legitimate tax deductions. Open a separate business bank account, save all your receipts, keep a log book of your car mileage, and keep track of all appropriate business-related expenses. Things will go a great deal more smoothly at tax time if you keep complete and accurate business records.

For more detailed information about business and personal expenses, ask for these free publications from the IRS.

- ▶ Publication 535, Business Expenses
- ▶ Publication 463, Travel, Entertainment, and Gift Expenses
- ▶ Publication 587, Business Use of Your Home
- ▶ Publication 917, Business Use of a Car ☺

.....
 Develop Good
 Bookkeeping
 Practices Today

One of the best investments of your time is setting up a bookkeeping system that will help you monitor your business and keep good records. Here are a few ideas that help make it easier.

- ✓ **Inventory Withdrawal:** Keep a separate record of any items in your inventory that you do not sell to a customer. Include in this record charitable contributions, personal use, theft, promotions, gifts, spoilage, etc. Make sure you have a clear record showing these goods were not actually sold.
- ✓ **Business Calendar:** Clearly show all your travel, business trip mileage, entertainment, etc.
- ✓ **Automobile Log:** Keep a handy logbook of all the business mileage you travel. Get into the habit of marking the mileage down immediately after each business trip, along with its business purpose.
- ✓ **Income:** Keep your cash register receipts, credit card slips, sales slips, invoices and any other record of your income.
- ✓ **Expenses:** Organize your expense records by type of expense (supplies, labor, transportation, etc.), as well as by date.
- ✓ **Payroll:** For each employee, you should have on file a Form W-4, "Employee's Withholding Allowance Certificate," as well as the employee's address, Social Security number, dates worked, amounts of wages and tips earned, and payroll taxes withheld.
- ✓ **Independent Contractors:** Keep on file all their names, addresses, taxpayer identification numbers, dates they worked for you, and amounts they earned. ☺

Advance

Extra \$\$ for Those Who Need It Most

The advance earned income tax credit (AEITC) may provide extra help for your employees who support children. If they will earn less than \$24,396 in 1995, they may qualify for up to \$105 more take-home pay a month.

To claim the AEITC, eligible employees should fill out a Form W-5, "Earned Income Credit Advance Payment Certificate," and return it to you. You then transfer the right amount of money from your regular federal tax deposits and include it in their pay. You **do not** use your own funds to make these payments.

EITC



For more information on the advance earned income tax credit and free information materials for employees, ask for the following free publications.

- ▶ Publication 15, Circular E—Employer's Tax Guide
- ▶ Publication 1844, AEITC Employer's Guide ☺



**Internal
Revenue
Service**

PC:C:C
1111 Constitution Ave., N.W.
Washington, DC 20224-2686

Official Business
Penalty For Private Use \$300
Address Correction Requested

Bulk Rate
Postage & Fees Paid
IRS
Permit No. G-48

Taxcalendar

August 2

Deposit payroll tax for payments on July 26, 27 and 28.

August 4

Deposit payroll tax for payments on July 29, 30, 31 and August 1.

August 9

Deposit environmental, fuel, luxury, retail and manufacturers tax for the last 16 days of July.

Deposit payroll tax for payments on August 2, 3 and 4.

August 10

File Form 941 for 2nd quarter of 1995 if you had deposited the taxes in full and on time.

August 11

Deposit payroll tax for payments on August 5, 6, 7 and 8.

August 14

Deposit gas tax for the last 16 days of July if the 14-day rule applies.

August 15

Deposit payroll tax for payments in July if the semi-weekly rule did not apply.

If you have a 4-month extension to file your tax return for 1994, file Form 1040.

August 16

Deposit payroll tax for payments on August 9, 10 and 11.

August 18

Deposit payroll tax for payments on August 12, 13, 14 and 15.

August 23

Deposit payroll tax for payments on August 16, 17 and 18.

August 24

Deposit environmental, fuel, luxury, retail and manufacturers tax for the first 15 days of August.

August 25

Deposit payroll tax for payments on August 19, 20, 21, and 22.

August 29

Deposit gas tax for first 15 days of August if the 14-day rule applies.

August 30


Deposit payroll tax for payments on August 23, 24 and 25.

August 31

File Form 2290 and pay heavy vehicle use tax for vehicles first used in July 1995.

File Form 730 and pay tax on bets accepted during July.

Editor: Donna J. Bell
Associate Editor: Kara O'Brien

 Department of the Treasury • Internal Revenue Service
Publication 1518 (Rev. 8/95) • Catalog No. 12350Z



For more information on other excise taxes, see Publication 509, "Tax Calendars for 1995," and Publication 510, "Excise Taxes for 1995."