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Recordkeeping - Common Requirements for Business Income & Expenses

If we've prepared your individual income tax return in the past, we've explained the importance of keeping records so that your tax return can be properly prepared and so that claimed items can be backed up in the event of an audit. Here, we focus on common records that are needed in connection with taxes on your business income. We also want to advise you of the opportunities and pitfalls in the IRS's recent guidance on electronic storage of records.

Keep records of all of your gross receipts. They are needed so that you can properly report gross income from the business activity and self-employment taxes owed on your net earnings. Self-employment taxes are equivalent to social security taxes paid by both an employee and the employer.

You must keep proper track of all expenses that are potentially deductible. To this end, keep track of compensation paid to employees and independent contractors, repairs, rents, taxes and licenses, bank charges, business insurance, utilities, postage and shipping charges, and travel and entertainment expenses, among other items.

On the subject of travel and entertainment expenses, there is some good news. Documentary evidence of business travel and entertainment expenses is not necessary for expenditures under \$75. The old threshold (pre-September 30, 1995) had been just \$25. For purposes of the \$75 rule, each separate payment is treated as a separate expenditure and you can treat a tip as a separate expenditure. Although you no longer need documentary evidence for many travel and entertainment expenses under \$75, you still must comply with other recordkeeping requirements to substantiate deductions, such as keeping records of the time, place and date of the business travel, and business reason for the travel, etc. Also, you still need bills and receipts for any lodging expense regardless of its amount. Although the 75 rule has been around for over Twelve years, Congress has not given any indication that it will raise this amount for inflation anytime soon.

Keep permanent records of assets that you depreciate. In fact, we recommend a 'fixed asset ledger' where you maintain a record and receipt of all current fixed assets. Keep receipts of how much you paid for the property and records showing when you placed assets in service or changed them from personal to business use. Also, keep records of capital improvements.

If you use your car in business, whether you base your deductions on actual expenses or you use an IRS standard mileage rate, there are a number of records that you must keep. They include records of business miles and total miles, records showing when you started using your car in business and its basis, records of actual expenses if you do not use the standard mileage rate, and a number of other items regardless of which alternative you use.

Similarly, very specific and detailed recordkeeping is required when you use a portion of your home in your business. Records must show the part of the home that is used for business and that such use is exclusive. Records also are needed to show the depreciation and expenses for the business part of the home.

The IRS has issued a revenue procedure applicable to taxpayers who maintain books and records using an electronic storage system. The IRS defines an electronic storage system as a system that prepares, records, transfers, indexes, stores, retrieves and reproduces records by either imaging hardcopy records or transfers computerized books and records to an electronic storage medium. The IRS has issued guidelines to insure the integrity of the system and governing controls, inspections and quality assurance. Although the taxpayer may destroy paper records if it has a system within the IRS's guidelines, we caution that potential penalties may not apply if the taxpayer maintains its original books and records, perhaps at a remote, low overhead location.

Please contact us if you have any questions about these or other recordkeeping requirements, particularly the electronic recordkeeping requirements, including those for any employment tax obligations that may arise in connection with your business.