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SMALL BUSINESS RECORDKEEPING

This information is designed to assist those who use our Excel Recordkeeping Module, but it also provides basic recordkeeping rules with which EVERY small business person should become familiar.

The Heritage Tax Recordkeeping Module is a spreadsheet that uses the Microsoft Excel spreadsheet program. It is designed for extremely small companies or individuals who are using the “cash” method of accounting and who have a single owner, operating as a sole proprietorship or as a Single Member LLC. It is ideal for small contractors, real estate agents, etc.

IMPORTANT: Even though you may be a small business, we strongly urge you to keep your business finances totally separate from your personal finances. To do this you should use a totally separate checking account for your business and, if you use a credit card, select a separate credit card that you use only for business if at all possible. Try to pay for ALL business expenses with the business checking account or the business credit card. In the rare occasion that you must pay cash out of your pocket, simply write a business check to yourself to pay yourself for the cash you had to use out of your pocket. That way, it is still tracked properly as a business expense.

It is extremely important for you to understand that this is NOT the same as keeping a full set of books.

This program is ONLY designed to assist you in keeping your records in an orderly format. This will not only help keep your tax preparation fees down, it will also enable you to have better information upon which to base your business decisions.

As your business grows, we urge you to talk to us about how we can save you time, money, and lots of headaches by having us become your full service bookkeeper!

As you read the instructions, they may seem a bit overwhelming at first because it was necessary to include so much detail in order to cover all the bases. Your actual usage will be far simpler than these instructions may make it appear.

Let me start by defining five terms:

- 1. Tab** – A tab is like what you might find at the top of a file folder where the label is that tells us what is inside the folder. The tabs for this spreadsheet are at the bottom instead of at the top.
- 2. Column** - A column collects information you enter going up and down the page.
- 3. Row** – A row collects information you enter going from left to right across the page.
- 4. Cell** – A cell is one block of information where a column and row intersect.

5. Cell Address – A cell address is where the lettered Column and the numbered Row intersect. For example, if I asked you to look at the January Tab, Cell G5, you would do the following:

- a. Click on the January Tab at the bottom of the page.
- b. Locate the “G” column.
- c. Go down to the 5th row.
- d. You will find the word “Inventory”.

This program consists of fourteen (14) tabs that are found at the bottom of the page. Just click on whichever tab you wish to look at or into which you wish to enter data. Here is a brief review of each tab:

1. The first tab is the ANNUAL TOTALS TAB

- a. The purpose of the first page is to summarize all of the information you enter of all of the other tabs.
 - i. Below the Columns headings you will find the totals for each category of income or expense for each month.
 - ii. At the bottom of the monthly totals, you will find the totals for each column for the year.
- b. The only entries you will EVER make on this tab are:
 - i. The Company Name
 - ii. The Title of the Spreadsheet
 - iii. The date the spreadsheet was created.
 - iv. The editable column headings beginning with the Office Supplies column (Column I). See the section below about using column headings.
 - v. Everything else will be self-calculated.

2. January through December Tabs

- a. You should use each of these tabs ONLY for transactions that occur for the month of that tab.
- b. A transaction is defined as ANY movement of money that affects your business. This includes deposits and expenses you incurred, whether you paid for those expenses with cash, check or credit card.
- c. Enter the date of the transaction in the first column.
- d. Enter what type of transaction this is.
 - i. Enter "Dep" for a Deposit
 - ii. Enter the "Check Number" if you paid this expense with a check
 - iii. Enter "Cash" if you paid this expense with cash.
 - iv. Enter "CC" if you paid this expense with a credit card.
- e. In the “PAID TO / RECEIVED FROM” column, enter the name of the customer / client from whom you received funds OR the name of the person / company from whom you purchased goods or services.
- f. For the "Income" column, enter the amount of any money you received for providing merchandise or services, no matter how it was paid, EVEN IF PAID THROUGH BARTER.

- g. Use the "Inventory" column for inventory. Please see the instructions below related to inventory.
 - h. Use the "Single Items costing over \$2500" tab for Depreciable Items. Please see the instructions below related to Depreciation.
 - i. For all of the remaining columns, follow these important instructions:
 - i. Only use ONE (1) single income or expense column per line.
 - ii. Choose the column that has a title that best fits the description of the expenses for which you are spending money. Please see the section below titled, "Suggested categories for the columns".
 - iii. If a column title does not exist, you can create one by changing "Specify" to an expense category which best describe what you are spending money for.
 - 1. For example, if you are buying a tool, you might change the title of a column from "Specify" to "Tools".
2. **TWO VERY IMPORTANT INSTRUCTIONS:**
- a. All columns titles can only be changed from the "ANNUAL TOTALS" Tab.
 - b. Once a column has been used, do not EVER change the name of that column again. ONE EXCEPTION: If you are editing for spelling or grammar, it is fine since that does not change the content or intent of the column.

3. Mileage Tab

- a. This is a sheet you can print off to keep a record of your vehicle usage.
- b. Complete one of these for each vehicle for each month of the year.
- c. See more detailed information below under "Car & Truck Expenses"

4. Suggested categories for the columns

- a. **Assets** – Certain assets must be tracked separately and individually.
 - i. These are purchases that meet **all three** of the following criteria.
 - 1. They must have a useful life of over one year.
 - 2. They must be material in value. In other words, they must have value of significance. Most items costing less than around \$2500 would not be considered an asset but would be an expense.
 - 3. Finally, if they are included in "Inventory" items as discussed next, then it would NOT fall into the category of "Assets".
 - ii. For assets that meet ALL of the three qualifications above, we need to know the following information for each individual item:
 - 1. What the item is. In order to determine the useful life (based on tables provided by the IRS). We will determine that for you when we prepare your tax return based on the information on the spreadsheet.
 - 2. The purchase price
 - 3. The date acquired.
 - iii. You may not be able to write off the entire deduction in the year of purchase. This will be discussed later in detail under a section labeled "Depreciation".
 - iv. We have already provided a column heading for this titled, "Single Items Costing Over \$2500".

b. **Inventory** (Cost of things you sell or leave with customer)

- i. Inventory is defined as any purchase that is designed for resale **OR** that is to be left permanently with a customer.
 1. This may be for resale, as is, or
 2. Items for resale when combined with other products or services to create an entirely different item. Some examples of this might include:
 - a. A person who buys inventory of jewelry parts and then creates a finished piece of jewelry.
 - b. A contractor who buys materials such as lumber, nails, screws, and such to go into a job. These materials are considered to be inventory.
- ii. Both a physical count and valuation of inventory must be taken once per year. It must be taken either on:
 1. The last day of each fiscal year (For most small businesses, this is December 31st) OR
 2. The first business day of the next fiscal year is also acceptable (For most small businesses, this is January 1st).
- iii. In order to make an accurate valuation of inventory, the following should be noted:
 1. Valuation uses the COST of the items, **NOT** the resale value or retail price.
 2. A method should be established to allow the business owner to track the cost of his/her inventory at all times.
 - a. Today, many small businesses use computer programs to track this information.
 - b. There are many small businesses still using the old manual methods of maintaining inventory values as well. Here is how that can be done:
 - i. At the time of purchase, place some type of sticker, tag, or other marking of some kind on all inventory items which shows, usually in some sort of code, exactly what was paid for that item.
 - ii. An example of a code would be to choose a 10 letter word. For example, if you choose the word, BLACKSTONE, then the code would work out as follows:
 1. B = 1
 2. L = 2
 3. A = 3
 4. C = 4
 5. K = 5
 6. S = 6
 7. T = 7
 8. O = 8
 9. N = 9
 10. E = 0

iii. Using the above code then, here are some examples of the result:

1. \$1.23 = BLA
2. \$3.21 = ALB
3. \$347.86 = ACTOS
4. \$5.00 = KEE

iv. While this may seem awkward at first, it very quickly becomes second nature so that it can be read far more quickly than most people would ever imagine.

3. The value of inventory (at cost) must be provided in order to complete your tax return each year.

4. Note that we have already provided a column for “Inventory”.

- c. **Payroll or Draws** – How you pay yourself depends on the business form you have chosen for your business. Note that all businesses, including a Limited Liability Company (LLC) must be one of the following in the eyes of the IRS:
- i. Sole Proprietorship – You will pay yourself using “Owner’s Draws”
 - ii. Partnership – You will pay yourself using “Partner’s Draws”
 - iii. Corporation – You will pay yourself using “Wages” and must have payroll withholding just like any other employee.
 - iv. Note that a separate and far more detailed discussion should take place for those who must withhold taxes for themselves or employees.
- d. **Income** may be lumped all into the single category of “Income” or may be tracked separately for various types of sales.
- i. One time when it is critical to track sales as a separate category is when some sort of separate reporting is required of those sales. The biggest single example of that is separating sales for items that are NOT subject to sales tax from those that ARE subject to sales tax.
 - ii. Optionally, one might wish to track sales from certain departments or certain types of products, etc.
 - iii. Our Recordkeeping Module only allows tracking for one single category of income. If you need more tracking, talk to us about our bookkeeping services.
 - iv. Note that “Refunds”, if any, must also be tracked.
 1. Refunds you give to your customers should be entered as a negative deposit.
 2. Refunds paid to you, when you return merchandise for credit, should be entered as a negative number in the same category in which it was entered when you purchased the item originally.
- e. **Expenses** – When deducting expenses, here are some common categories:
- i. Individual Assets – **as discussed above**
 - ii. Inventory or Cost of Goods Sold – **as discussed above**
 - iii. Payroll or draws – **as discussed above**
 - iv. Advertising
 - v. Car or Truck Expenses – **as discussed later**
 - vi. Commissions or fees

- vii. Contract Labor – **as discussed later**
- viii. Employee benefit programs
- ix. Insurance – health for owner(s)
- x. Insurance – health for employee(s)
- xi. Insurance – all other
- xii. Mortgage Interest
- xiii. Other Interest
- xiv. Legal and professional service
- xv. Office supplies
- xvi. Pension and Profit sharing
- xvii. Rent or lease payments for buildings
- xviii. Rent for vehicles or machinery
- xix. Repairs and maintenance
- xx. Supplies other than office supplies
- xxi. Taxes and licenses
- xxii. Travel – as discussed later
- xxiii. Meals and entertainment – as discussed later**
- xxiv. Utilities
- xxv. Wages (but NOT draws of owners)
- xxvi. Other – There are many other categories of expenses that are too numerous to name and many that are unique to each specific business. Each business owner should categorize their expenses as much as possible. **It is vital to avoid categories such as “Other” or “Misc”.**

f. **Car and Truck Expenses**

- i. Regardless of how one deducts vehicle expenses, the following FOUR items of information **MUST** be tracked for each vehicle used for business purposes:
 - 1. Business Miles
 - 2. Personal Miles
 - 3. Commuting Miles
 - a. Commuting is defined as the miles driven to and from work.
 - b. For a self-employed person, this is generally defined as the distance from home to the first business stop of the day and then returning home from the last business stop of the day.
 - c. Commuting miles are NOT deductible.
 - 4. Total of ALL miles above combined (We suggest that you write down your mileage for each vehicle at end of day December 31st or beginning of day January 1st).
 - 5. If we have any three of the above, we can make a math calculation to determine the fourth.
 - 6. The above **MUST** be tracked separately for each vehicle.
- ii. There are two methods that may be used to deduct vehicle expenses:
 - 1. Standard Mileage Deduction – With this method you simply multiply the business miles (as you have tracked as instructed above) by a mileage rate established by the IRS.

2. Actual Expenses – here you deduct the actual amount of all expenses used for business purposes. Although you can only deduct your business expenses, it is vital you keep record of ALL expenses related to the vehicle, even the personal expenses. You still need to know the mileage and the reason will be explained shortly. You can deduct expenses such as:

- a. Gas
- b. Oil
- c. Maintenance
- d. Repairs
- e. Insurance
- f. Depreciation
- g. The total of these expenses will be multiplied by the percentage of total miles vs. the business miles. Here is an example. Let's say that your total vehicle expenses came to \$9000 and you had 22,000 business miles out of 35,000 total miles. Well, that means that 63% of your total mileage was business mileage. Therefore you can deduct \$5670, which is 63% of your total expenses of \$9000.

- g. **Contract Labor vs. Wages** – When paying those working for you, you must determine whether the person is an employee or an independent contractor. This is NOT something about which you are allowed to make an arbitrary decision. It is governed by specific sets of rules. In most cases, the IRS is increasingly determining that workers treated as independent contractors are NOT really independent contractors at all, but are actually employees. **This can be an incredibly costly error. As a result, we urge you to give this serious attention!** The IRS has released a small pamphlet for making an accurate determination. Please ask us for a copy or download IRS Publication 1779 from the internet.
- h. **Depreciation** – This is a deduction that allows you to write off the purchase price of “Assets” as discussed earlier. This is a very complex subject so we will only address some very basic aspects here.
 - i. There are many variables in calculating depreciation. You do not need to know or understand how all of this works, but I will provide one example of depreciation, using the purchase of a piece of equipment. We are required to write off the price of the computer over a 5 year period. Therefore, using the simplest method of depreciation, you deduct 20% of your purchase price per year. For a \$10,000 purchase, you deduct \$2000 per year for 5 years.
 - ii. At the time that you sell, give away, or discard the asset, you must report its disposal and determine whether you deducted too much depreciation or too little depreciation.
 - iii. For example, if the \$10,000 piece of equipment you purchased above dies after 3 years, you will dispose of it and report it as though it were sold for \$0. So far, you had only deducted the \$2000 per year for 3 years. Well, obviously, the equipment had depreciated down to \$0 since you threw it away. Therefore, you can now deduct the remaining \$4000 on the tax return for the year, because the

computer became worthless. . *This is example of under-depreciating an item; and the under-depreciation is only temporary, as you finish claiming the full deduction in the year the equipment dies.*

- iv. On the other hand, if after three years, you sell the equipment for \$6500, then you will note that the computer has only depreciated \$3500 (You paid \$10,000 but got \$6500 when you sold it; hence it only lost \$3500 of value). Since you will have depreciated it on your tax return for \$2000 per year for 3 years (\$6000), you will have over-depreciated by \$2500 (the \$6000 you deducted minus the \$3500 by which the computer actually depreciated). *Again, this over-depreciation is only temporary, as you will “recapture the unearned depreciation” in the year you sell the computer. Unearned depreciation on over-depreciated items is taxable income.*
- v. Usually, items will depreciate somewhat closely in line with the deductions you have taken, so there will very little difference between what you have put on your return and what has actually happened, and very little income (over-depreciation) or deductions (under-depreciation) will be created. There is one very notable exception to that rule discussed next.
- vi. Since rental real estate normally doesn’t depreciate (at least, we hope it doesn’t), then normally ALL deprecation deducted will have to be recaptured. Some people then ask, “Why do we even do it?” We do it because the IRS REQUIRES it. As a result, it is important to think of depreciation on real estate as an interest free loan that will have to be repaid when the real estate is sold. **Any time you contemplate selling real estate, or any other major asset, we URGE you to call us to discuss the tax ramifications of the sale.**
- i. **Meals and Entertainment** – There are limitations as to what is deductible for meals and entertainment. Here are some guidelines:
 - i. The meal or entertainment must have a business purpose. You MUST keep a record of, not only the expense, but the business purpose (including the name of any customer/client).
 - ii. In almost all cases, you can only deduct 50% of the expense.

PLEASE NOTE THAT THIS IS A VERY BASIC REVIEW OF RECORD KEEPING AND THERE IS MUCH, MUCH MORE INVOLVED THAT WE DO NOT COVER HERE.

PLEASE CALL US FOR ASSISTANCE!

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