

# tax season simplified

Prepare your business for tax season by following a few essential guidelines

**W**hen Bob Whitaker opened several small businesses in the early 1990s, he never envisioned that tax preparation would become such a time-consuming ordeal. Whitaker, who left a sales career to start a photography studio and a marketing business, soon faced multiple IRS audits within just a few years.

No small business owner wants to suffer through even one audit. Beyond mere hassle, the stakes are high when capital and manpower are already stretched thin. For Whitaker, though, the experience turned into an entrepreneurial opportunity. He delved into the minutiae of small business tax law and created a product, the Tax MiniMiser, that helps small business owners track deductions.

By packaging the lessons he learned about tax organization, Whitaker devised a tool to save time and money on tax preparation. And several years later, when the IRS wanted to audit his records again, Whitaker was well prepared. With his own product, he had completely organized his tax-related documents. "The auditor went through my records and found legitimate deductions and complete documentations," he recalls. "It was the ultimate test."



TAXES  
by Chris Warren



MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY	SATURDAY
	1	2	3	4	5
	8	9	10	11	12
	15	16	17	18	19
	22	23	24	25	26

## Keeping Track

Small business owners, even seasoned ones, often approach business tax receipts much as they approach personal income tax records. Amid daily business duties, they haphazardly collect some receipts and canceled checks and hope that they don't owe anything when the April deadline rolls around. That simply doesn't cut it, says Barbara Weltman, author of *J.K. Lasser's Small Business Taxes 2008*. "The tax law requires that business owners keep books and records," she says. "You don't have a choice."

Instead of occasionally throwing documents in a folder, effective bookkeepers maintain current records throughout the year. For tax purposes, records pertaining to earned income and legitimate expenses are most critical. The Schedule C tax form, used by sole proprietors to report business profits or losses, helps to identify items that need to be documented. Maintain expense records related to inventory purchases, wages, materials and supplies, lodging and travel, business interest expense and business vehicle usage. Also keep up with income records like gross receipts and sales, returns and allowances as well as collected state sales tax.

Some business owners use a separate folder for each month for their paper records. While collecting the documents, keep in mind that the IRS has specific record-keeping rules for certain deductions. Take, for example, the rules for deducting a business meal. "You not only need a receipt to prove the amount of the expense, which could be a credit-card slip, but you also need a diary or expense account statement that shows a lot of specific information," Weltman says. "For a meal, it's who you took out and why, what you discussed, when it happened and where you went."

So how long should business owners keep those documents? Because the IRS usually has three years to audit a firm, Weltman says it's wise to keep all receipts and tax-related documents organized and filed for at least that long. But it's also a good idea to hold on to a copy of your filed tax return permanently, along with a confirmation

that the IRS received it, because audits can be conducted beyond the three-year mark if the IRS suspects a business never filed a return. Retaining so many records can present storage problems, so Weltman suggests scanning all your tax documents and saving them on a DVD. If space needed for more urgent files is cramped, consider renting a storage facility.

For some small business owners, the task of maintaining such detailed records might simply be too onerous or time consuming. In that case, experts suggest enlisting the help of a professional bookkeeper.

## Four Business Deductions to Remember

### 1

Carryovers from prior years for net operating losses and capital losses

### 2

Theft and casualty losses, which are fully deductible

### 3

Interest payments on business loans, including credit-card borrowing

### 4

Incidental costs of business travel, such as laundry

## Quarterly Dues

No matter who handles a company's records, the IRS requires that businesses expecting to owe at least \$1,000 in federal taxes pay estimated taxes on a quarterly basis. Eva Rosenberg, author of *Small Business Taxes Made Easy*, says that despite this requirement, far too many entrepreneurs wait until the end of the year, when they don't have enough cash to pay their full tax bill. "They owe a significant amount of money later on because they neglected to submit taxes during the year," she says. "So in April they don't have the money and they need an extension."

In addition to budgeting issues, missing quarterly estimated tax payments can lead to other problems. The IRS may levy penalties on a business that skips payment of estimated taxes. And failure to track tax implications of business expenses and income throughout the year can cloud the picture of how a company is performing.

There are some exceptions to the quarterly estimated tax rule, however. If a business does not make any profit one year, it may not be required to make estimated payments the following year. To avoid penalties, business owners should refer to the previous year's tax return. If a business pays the same amount in estimated taxes for the current year as it did in the previous year (or pays 110% of last year's taxes if income is over \$150,000), the IRS cannot penalize it.



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## Avoiding an Audit

Paying estimated taxes on time and being diligent about record-keeping can reduce the chances of an audit. In addition to those proactive measures, avoid activities that flag the attention of the IRS. “Very high meal and entertainment expenses in proportion to your income will stand out,” Rosenberg says, “especially if the expenses are greater than your income.” She also warns business owners against claiming too much in the miscellaneous category.

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Small businesses that lose money but pay employees high salaries often attract an auditor’s attention, Rosenberg adds. “If someone is making \$80,000 in a business that loses \$30,000, then the IRS may think it’s a hobby the person is trying to write off as a tax benefit.”

Deductions related to automobiles and home offices can also attract the interest of the IRS. While these can still be valuable deductions to take, Rosenberg says business owners should be meticulous in documenting the reasons for such write-offs. For instance, if you claim a home-office deduction, be sure the office is used exclusively for your business.

While few business owners will face the tax challenges that Bob Whitaker confronted, the lessons he learned are widely applicable. Entrepreneurs who maintain organized, complete records and handle tax payments throughout the calendar year can expect a simple and successful tax filing. ■