

Summary of Certain Documentation Requirements

Upon audit, it is not usually a matter of law that causes a business to owe more tax; it is usually the lack of documentation. We are going to cover some of the areas we have noticed clients have the most problems with. This is intended to be a clarification of problem areas and a thorough discussion will usually be necessary to make sure your particular situation meets the requirements of the law.

1. Home Office – In order to qualify for a home office there must be an area (not necessarily a separate room) set aside to be used EXCLUSIVELY for business in the ADMINISTRATION of your business. Storage or a workshop is not sufficient; there must be administration functions performed. We can provide you with a checklist to help you determine if your situation qualifies. We have asked you to provide us a **WRITTEN** statement that you have written records to support the deduction you are claiming each year.
2. Vehicle Expenses - This section does not include travel expenses for travel to work outside your normal local work area and will be discussed in a separate section. You are not entitled to deduct local vehicle expenses from your home to your first work location unless your home is also your office as described above. Once you arrive at your first work location for any given day then all additional local business travel would be deductible; however, you need to be able to document this travel. Keep in mind your travel back home at the end of your work day is also a non-deductible commute unless you have a home office. The best practice for documenting your business travel is a log that notes the date, starting point, destination, and reason for the trip. There are additional methods for documenting your business travel and you can schedule an appointment with us to discuss them. An example is if you drive the same route each week you are allowed to use a sampling method to document your mileage records. We will require you to submit **a written statement to us** for **each year** you have vehicle expenses. This statement will include your business, commuting & personal mileage for each vehicle used. Included in your written statement to us you have to tell us if you have written documentation of the mileage. There is a worksheet available at our website, www.meredithandelkinspllc.com.
3. For each purchase that you make, the best receipt is a hand written signed document or cash register receipt noting the amount of the disbursement detailing the items or services purchased. If you do not have some type of written documentation for each disbursement you make, it is possible it will be disallowed on audit. If for some reason you are not able to obtain a written receipt or it is not legible, you should prepare a handwritten explanation of the circumstances, sign and date that statement for your records. Generally, the monthly credit card statement will not be considered a receipt; therefore you will need the actual receipt for that item.
4. We have sent out notifications over the last several years regarding the importance of 1099's. We have included in this mailing some information regarding the filing of these forms and the documentation required of you. What we want to impress upon you is the severe penalties the IRS can impose for failing to comply with this area of tax law. First, there is a \$100 per document penalty for failing to issue a 1099. The IRS can also impose a penalty of 20% of the amount of the 1099 if they decide the omission was a willful intent to not comply with the law. For each 1099 that you issue you should have a signed W-9. Having the vendors name, address and social security number is not sufficient. The reasoning behind this is the person with whom you are contracting for services could owe back taxes and you would be required to withhold 28% "backup withholding" from the amount you owe the vendor. You then would be required to send the IRS the 28% withheld. When the vendor signs the W-9, they are attesting to you that they are not subject to backup withholding. The IRS does match the name and ID # on the 1099's submitted. To avoid receiving a letter from the IRS, you should examine

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each W-9 that is returned to you. If a vendor submits a federal ID # then the name of the business should be on the W-9 & 1099. If a vendor uses their social security number, then owners name should be on the W-9 & 1099. For the preparation of your return, you will need to inform us whether you were required to send any 1099's, and, if so, whether you did or will. You can do this on the business expense form or the 1099 letter available at our website, www.meredithandelkinspllc.com.

5. Income Receipts - You should have a computer or hand written receipts journal that reconciles with your total bank deposits after accounting for any cash paid out. You also need a cash paid out record detailing and reconciling money not deposited into your bank account. If there are deposits to your bank accounts that you cannot explain, the IRS could take the position that these deposits are taxable income to you.
6. Employees - You should have a file for each employee. The file should include a W-4, I-9 and a copy of the report of new hires to TDLWD prepared, signed & dated by the employee. You should have an employee manual that explains the policies that govern the relationship between you and your employees. Policies could include, but not be limited to, sick day policies, vacation policies, hiring, dismissal and that you comply with all anti-discrimination laws. You are required to post certain laws in your business where employees have access. We can help you get started on this if it is an area of concern with your company, but in many cases you will need to consult with a labor lawyer as our area is tax compliance. There are situations where employees and shareholders will need to add amounts for non-cash benefits such as health insurance and personal use of company vehicles to their W-2 wages. Please review the Payroll Compliance Checklist available at our website, www.meredithandelkinspllc.com.
7. Hobbies - There are very restrictive rules related to activities the IRS considers to be engaged in for reasons other than a profit motive. This is another area where it is very complicated to make a determination and we have a several page written discussion we can provide to help you make this determination. Generally, the IRS will consider that a business, including farming that loses money consistently year after year to be a hobby. The burden is on you, the taxpayer to prove that it is a for profit venture. You will need to carefully document your activities where this is concerned. A more detailed discussion is available at our website, www.meredithandelkinspllc.com.
8. Corporate and business administrative records - While a corporation is required to keep its by-laws and meeting minutes, or risk losing its corporate status, **ALL** businesses should have a file of all contracts, bank agreements, financial records, meeting minutes, etc.
9. Travel away from home - When you work outside of your normal work area you are entitled to deduct travel expenses. Where and what depends on the specific facts and circumstances. This is so specific to each situation, to make the recitation of the general rules is not practical in this letter.
10. Accountable reimbursement plans – Your business needs a written reimbursement plan to be able to reimburse business expenses to your companies' employees and shareholders. The same goes for partners in a partnership. At a minimum, the reimbursement plan has to include your companies' policy for advancing expense money. An accounting of the actual expenses that pertain to the advance has to be provided to the company within 30 days after the advance is disbursed. For reimbursed expenses, the company has 60 days to pay the expenses. Again adequate documentation is a must in sustaining these types of deductions. These rules do not apply to self-employed individuals. See item 3.