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Starting a Business and Keeping Records

Contents

Introduction

This publication provides basic federal tax information for people who are starting a business. It also provides information on keeping records and illustrates a record-keeping system.

Throughout this publication we refer you to other IRS publications and forms where you will find more information. In addition, you may want to contact other government agencies, such as the Small Business Administration (SBA). See page 2 to find out how to get more information.

Where To Go for Help

This section describes the help that the IRS and other federal agencies offer to taxpayers who operate their own businesses.

Internal Revenue Service

The following describes assistance provided by the IRS.

Small Business Tax Education Program. Small business owners and other self-employed individuals can learn about business taxes through a unique partnership between the IRS and local organizations. Through workshops or in-depth tax courses, instructors provide training on starting a business, recordkeeping, preparing business tax returns, self-employment tax issues, and employment taxes.

Some courses are offered free as a community service. Courses given by an educational facility may include costs for materials and tuition. Other courses may have a nominal fee to offset administrative costs of sponsoring organizations.

For more information about this program, call the IRS Monday through Friday during regular business hours. Check your telephone book for the local number of the IRS office closest to you or you can call **1-800-829-1040**.

Your Business Tax Kit. *Your Business Tax Kit* is an assortment of IRS forms and publications to help taxpayers who operate their own businesses. To order the kit, call the number listed later under *Ordering publications and forms*. The kit consists of the following items:

Forms:

- ☐ SS-4, *Application for Employer Identification Number*
- ☐ 1040-ES, *Estimated Tax For Individuals*

Publications:

- ☐ 334, *Tax Guide for Small Business*
- ☐ 583, *Starting a Business and Keeping Records*
- ☐ 594, *Understanding the Collection Process*
- ☐ 910, *Guide to Free Tax Services*
- ☐ 1057, *Small Business Tax Education Program Brochure*
- ☐ 1544, *Reporting Cash Payments of Over $10,000 (Received in a Trade or Business)*
- ☐ 1779, *Employee or Independent Contractor*

It also contains Publication 509 which has a tax calendar.

Ordering publications and forms. To order free publications and forms, call **1-800-TAX-FORM** (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your tax package for the address.

If you have access to a personal computer and a modem, you can also get many forms and publications electronically. See *How To Get Forms and Publications* in your income tax package for details.

Telephone help. You can call the IRS with your tax question Monday through Friday during regular business hours. Check your telephone book for the local number or you can call **1-800-829-1040.**

Telephone help for hearing-impaired persons. If you have access to TDD equipment, you can call **1-800-829-4059** with your tax question or to order forms and publications. See your tax package for the hours of operation.

Small Business Administration

The Small Business Administration (SBA) is a federal agency that offers training and educational programs, counseling services, financial programs, and contract assistance to small business owners. The SBA also has publications and videos on a wide range of business topics. If you want information from the SBA on setting up a business, look in your telephone directory under ''U.S. Government'' for the number of your local SBA office or call the Small Business Answer Desk at **1-800-8-ASK-SBA**.

Other Federal Agencies

Other federal agencies also publish publications and pamphlets to assist small businesses. For a list of federal publications that are for sale write to:

Superintendent of Documents
U.S. Government Printing Office
P.O. Box 371954
Pittsburgh, PA 15250-7954

Table 1. **What New Business Owners Need To Know About Federal Taxes**
(**Note:** As a new business owner, the following questions are intended to give you an overview of your federal tax responsibilities. Page numbers are given to help you find the related discussion in this publication.)

☞ **What Must I Know**	☞ **Where To Find The Answer**
What are the different forms of business?	See *Forms of Business* below.
Will I need an employer identification number (EIN)?	See *Identification Numbers* on page 4.
Do I have to start my tax year in January? Or may I start it in any other month?	See *Tax Year* on page 5.
What method can I use to account for my income and expenses?	See *Accounting Method* on page 6.
What kinds of federal taxes will I have to pay?	See *Business Taxes* on page 6.
How should I pay my taxes?	See *Business Taxes* on page 6.
What must I do if I have employees?	See *Employment Taxes* on page 8.
What forms must I file?	See *Table 2* on page 7 and *Information Returns* on page 10.
Are there penalties if I do not pay my taxes or file my returns?	See *Penalties* on page 10.
What business expenses can I deduct on my federal income tax return?	See *Business Expenses* on page 10.
What records must I keep? How long must I keep them?	See *Recordkeeping* on page 12.

What New Business Owners Need To Know

Table 1 above provides a list of questions you need to answer to help you meet your federal tax obligations. After each question is the page in this publication where you can find the answer.

In addition to knowing about federal taxes, you need to make some basic business decisions. Ask yourself:

- What are my financial resources?
- What products and services will I sell?
- How will I market my products and services?
- How will I develop a strategic business plan?
- How will I manage my business on a day-to-day basis?
- How will I recruit employees?

The Small Business Administration (SBA) is a federal agency that can help you answer questions such as those listed above. For information on how to contact the SBA, see page 2.

Forms of Business

When beginning a business, you must decide which form of business to use. Legal and tax considerations enter into this decision. Only tax considerations are discussed in this publication.

The most common forms of business are the sole proprietorship, partnership, and corporation.

Sole proprietorships. A sole proprietorship is an unincorporated business that is owned by one individual. It is the simplest form of business organization to start and maintain. The business has no existence apart from you, the owner. Its liabilities are your personal liabilities and you undertake the risks of the business for all assets owned, whether used in the business or personally owned. You include the income and expenses of the business on your own tax return.

☞ Use a separate Schedule C (Form 1040), *Profit or Loss From Business,* to report the profit or loss from each business (except farming) you operate as a sole proprietorship. If you have only one business, you may be able to use Schedule C-EZ, *Net Profit From Business.*

☞ If you are the sole proprietor of a farming business, use Schedule F (Form 1040), *Profit or Loss From Farming,* to report your profit or loss.

☞ For more information on sole proprietorships, see chapter 27 in Publication 334. But if you are a farmer, see Publication 225, *Farmer's Tax Guide.*

Partnerships. A partnership is the relationship existing between two or more persons who join to carry on a trade or business. Each person contributes money, property, labor, or skill, and expects to share in the profits and losses of the business.

A partnership is not a taxable entity. Each partner includes his or her share of the income or loss on his or her tax return.

☞ Use Form 1065, *U.S. Partnership Return of Income,* to report the profit or loss of a partnership.

☞ For more information on partnerships, see Publication 541, *Tax Information on Partnerships.*

Corporations. In forming a corporation, prospective shareholders transfer money, property, or both, for the corporation's capital stock. A corporation generally takes the same deductions as a sole proprietorship to figure its taxable income. A corporation can also take special deductions.

The profit of a corporation is taxed to both the corporation and to the shareholders when the profit is distributed as dividends. However, shareholders cannot deduct any loss of the corporation.

☞ Most corporations file Form 1120, *U.S. Corporation Income Tax Return* or Form 1120-A, *U.S. Corporation Short-Form Income Tax Return.*

☞ For more information on corporations, see Publication 542, *Tax Information on Corporations.*

S corporations. An eligible domestic corporation can avoid double taxation (once to the shareholders and again to the corporation) by electing to be treated as an S corporation. An S corporation may also be exempt from federal income tax. Its shareholders include on their tax returns their share of the corporation's separately stated items of income, deduction, loss, and credit, and their share of nonseparately stated income or loss.

☞ A corporation elects to be treated as an S corporation by filing Form 2553, *Election by a Small Business Corporation*.

☞ An S corporation files its return on Form 1120S, *U.S. Income Tax Return for an S Corporation.*

☞ For more information on S corporations, see Publication 589, *Tax Information on S Corporations.*

Identification Numbers

You must have a taxpayer identification number so that the IRS can process your returns. There are two kinds of taxpayer identification numbers—a social security number (SSN) and an employer identification number (EIN).

☞ An SSN is issued by the Social Security Administration and is in the following format:
000–00–0000

☞ An EIN is issued by the IRS and is in the following format:
00–0000000

You must include your taxpayer identification number (SSN or EIN) on all returns or other documents you send to the IRS. You must also furnish your number to other persons who use your identification number on any returns or documents they send to the IRS. This includes returns or documents they file to report:

1) Interest, dividends, royalties, etc., paid to you.
2) Amounts paid to you (in your business) that total $600 or more for the year.
3) Any amount paid to you as a dependent care provider.
4) Alimony paid to you.

If you do not furnish your identification number as required, you will be subject to penalties.

Employer Identification Number (EIN)

EINs are used to identify the tax accounts of employers, sole proprietors, corporations, partnerships, estates, trusts, and other entities.

If you don't already have an EIN, you need to get one if you:

1) Have employees,
2) Have a Keogh plan,

3) Operate your business as a corporation or partnership, or
4) File any of these tax returns:
   a) Employment.
   b) Excise.
   c) Alcohol, tobacco, and firearms.

How To Get an EIN

You can get an EIN either through the mail or by telephone. But first you must fill out Form SS–4, *Application for Employer Identification Number*. You can get Form SS–4 at IRS or Social Security Administration (SSA) offices.

When to apply. You should apply for an EIN early enough to receive the number by the time you must file a return or statement or make a tax deposit. If you apply by telephone, you can get an EIN immediately. If you apply by mail, file Form SS–4 at least 4 to 5 weeks before you need an EIN.

If you do not receive your EIN by the time a return is due, file your return anyway. Write ''Applied for'' and the date you applied for the number in the space for the EIN.

More Than One EIN

If you have more than one EIN and are not sure which to use, contact the IRS Center where you file your return. Tell them the numbers you have, the name and address you used on each application, and the address of your principal place of business. They will tell you which number to use.

More Information

For more information about EINs, get Publication 1635, *Understanding Your EIN.*

Payee's Identification Number

In the operation of a business, you will probably make certain payments you must report on information returns, discussed later under *Information Returns*. You must give the recipient of these payments (the payee) a statement showing the total amount paid during the year. The forms used to report these payments must include the payee's identification number, as well as your identification number.

Employee. If you are an employer, you must get an SSN from each of your employees. Record the name and number of each employee exactly as they are shown on the employee's social security card. If the employee's name is not correct as shown on the card, including if the employee's name has changed due to marriage or divorce, the employee should request a new card from the SSA.

If your employee does not have an SSN, he or she should file Form SS–5, *Application for a Social Security Card,* with the Social Security Administration. This form is available at SSA offices or by calling 1-800-772-1213.

Other payee. If you make payments to a nonemployee that you report on an information return, get an SSN from each individual (including sole proprietors). If you make payments to an organization, such as a corporation or partnership, you must get its EIN.

To get the payee's SSN or EIN, use Form W–9, *Request for Taxpayer Identification Number and Certification.* This form is available from IRS offices.

☞ A payee who does not provide you with an identification number may be subject to backup withholding of 31%.

☞ For information on backup withholding, see Form W-9 and the *Instructions for Forms 1099, 1098, 5498, and W-2G.*

Tax Year

You must figure your taxable income and file an income tax return based on an annual accounting period called a tax year. A tax year is usually 12 consecutive months. There are two kinds of tax years:

Calendar

Fiscal

☞ A ***calendar year*** is 12 consecutive months beginning January 1 and ending December 31.

☞ A ***fiscal year*** is 12 consecutive months ending on the last day of any month other than December, or a 52-53 week year.

If you operate a business as a sole proprietor, the tax year for your business must be the same as your individual tax year.

Special rules apply to S corporations and partnerships.

For more information, see Publication 538, *Accounting Periods and Methods*.

First-time filer. If you have never filed an income tax return, you can choose either a calendar year or a fiscal tax year. You must choose a tax year by the time set by law, not including extensions, for filing your first return.

You must use the calendar year if you have inadequate records or you have no accounting period, or your annual accounting period does not qualify as a fiscal year.

Changing your tax year. Once you have chosen your tax year, you may have to get permission from the IRS to change it. To get permission, you must file Form 1128 and pay a fee. For more information, see Publication 538.

Accounting Method

An accounting method is a set of rules used to determine when and how to report income and expenses in your books and on your income tax returns.

The two basic accounting methods are the:

1) Cash method, and
2) Accrual method.

For other methods, see Publication 538, *Accounting Periods and Methods.*

> ☞ Under the **cash method**, you report income you receive during the year. You usually deduct expenses in the tax year you pay them.
>
> ☞ Under the **accrual method**, you generally report income when you earn it, even though you may receive payment in a later year. You deduct expenses in the tax year you incur them, whether or not you pay them in the same year.

If you need inventories to show income correctly, you must generally use an accrual method of accounting for purchases and sales. ***Inventories*** include goods held for sale in the normal course of business. They also include raw materials and supplies that will physically become a part of merchandise intended for sale.

You must use the same accounting method from year to year to figure your taxable income and keep your books if that method clearly shows your income. In general, any accounting method that consistently uses accounting principles suitable for your trade or business clearly shows income. An accounting method clearly shows income only if it treats all items of gross income and expense the same from year to year.

More than one business. When you own more than one business, you can use a different accounting method for each business if the method you use for each clearly shows your income. You should keep a complete and separate set of books and records for each business.

Changing your method of accounting. Once you have set up your accounting method, you must get permission from the IRS before you can change to another method. A change in accounting method not only includes a change in your overall system of accounting, but also a change in the treatment of any material item. For examples of changes that require permission and information on how to get permission for the change, see Publication 538.

Business Taxes

The form of business you operate determines what taxes you must pay and how you pay them. There are four general kinds of business taxes:

1) Income tax.
2) Self-employment tax.
3) Employment taxes.
4) Excise taxes.

See Table 2 for the forms you file to report these taxes.

TIP *You may want to get Publication 509. It has tax calendars that tell you when to file returns and make tax payments.*

Income Tax

All businesses except partnerships must file an annual income tax return. Partnerships file an information return. Which form you use depends on how your business is organized. See Table 2 to find out which return you have to file.

The federal income tax is a pay-as-you-go tax. You must pay the tax as you earn or receive income during the year. An employee usually has income tax withheld from his or her pay. If you do not pay your tax through withholding, or do not pay enough tax that way, you might have to pay estimated tax.

Estimated tax. Generally, sole proprietors, partners, and shareholders of an S corporation pay tax on income by making regular payments of estimated tax during the year. If you expect to owe taxes, including self-employment tax (discussed next), of $500 or more when you file your return, you generally have to make estimated tax payments. Use Form 1040-ES, *Estimated Tax for Individuals,* to figure and pay the tax. If you are not required to make estimated tax payments, you may pay any tax due when you file your return. For information on estimated tax, see Publication 505.

Corporations. A corporation must deposit the taxes it owes, including estimated tax payments and any balance due shown on its tax return. For information on how to make tax deposits, see *Depositing Taxes,* later.

Table 2. **Which Forms Must I File?**

If You Are A:	You May Be Liable For:	Use Form:
Sole proprietor	Income tax	1040 and Schedule C or C–EZ[1] (Schedule F for farm business[1])
	Self-employment tax	1040 and Schedule SE
	Estimated tax	1040–ES
	Employment taxes:	
	• Social security and Medicare taxes and income tax witholding	943 for farm employees 941 for all others
	• Federal unemployment (FUTA) tax	940 or 940–EZ
	• Depositing employment taxes	8109
	Excise taxes	See *Excise Taxes*
Partnership	Annual return of income	1065
	Employment taxes	Same as sole proprietor
	Excise taxes	See *Excise Taxes*
Partner in a partnership (individual)	Income tax	1040 and Schedule E[2]
	Self-employment tax	1040 and Schedule SE
	Estimated tax	1040–ES
Corporation or S corporation	Income tax	1120 or 1120–A (corporation) 1120S (S corporation)
	Estimated tax	1120–W (corporation only) and 8109
	Employment taxes	Same as sole proprietor
	Excise taxes	See *Excise Taxes*
S corporation shareholder	Income tax	1040 and Schedule E[2]
	Estimated tax	1040–ES

[1] File a separate schedule for each business.
[2] Various other schedules may be needed.

Self-Employment Tax

Self-employment tax is the social security and Medicare tax for individuals who work for themselves. Your payments of self-employment tax contribute to your coverage under the social security system. Social security coverage provides you with retirement benefits, disability benefits, and medical insurance (Medicare) benefits.

You must pay self-employment tax if:

1) Your net earnings from self-employment (not including church employee income) are $400 or more, or
2) You have church employee income of $108.28 or more.

☞ Use Schedule SE (Form 1040) to figure your self-employment tax.

☞ For more information, see Publication 533, *Self-Employment Tax.*

TIP *Deduct one-half of your self-employment tax as an adjustment to income on your Form 1040.*

Employment Taxes

This section briefly discusses the employment taxes you must pay, the forms you must file to report them, and other forms that must be filed when you have employees.

If you have employees, you will need to get Publication 15, *Circular E, Employer's Tax Guide.* If you have agricultural employees, get Publication 51, *Circular A, Agricultural Employer's Tax Guide.* These publications explain your tax responsibilities as an employer.

To help you determine whether the people working for you are your employees, get Publication 15-A, *Employer's Supplemental Tax Guide*. That publication has information to help you determine whether an individual is an employee or an independent contractor. If you classify an employee as an independent contractor, you can be held liable for employment taxes for that worker plus a penalty. An ***independent contractor*** is someone who is self-employed. You do not generally have to withhold or pay any taxes on payments to an independent contractor.

☞ Most employers must withhold (except FUTA), deposit, report, and pay the following employment taxes—

Federal income tax
Social security and Medicare taxes
Federal unemployment (FUTA) tax

Federal Income, Social Security, and Medicare Taxes

You withhold federal income tax from your employee's wages. To figure how much federal income tax to withhold from each wage payment, use the employee's Form W-4 (discussed later) and the methods described in Publication 15.

Social security and Medicare taxes pay for benefits the workers and their families receive under the Federal Insurance Contributions Act (FICA). Social security tax pays for benefits under the old-age, survivors, and disability insurance part of FICA. Medicare tax pays for benefits under the hospital insurance part. You withhold part of these taxes from your employee's wages and you pay a matching amount yourself. To find out how much social security and Medicare tax you have to withhold and to pay, see Publication 15.

☞ Farm employers report these taxes on Form 943, *Employer's Annual Tax Return for Agricultural Employers.*

☞ Other employers use Form 941, *Employer's Quarterly Federal Tax Return.*

Federal Unemployment (FUTA) Tax

The federal unemployment tax is part of the federal and state program under the Federal Unemployment Tax Act (FUTA) that pays unemployment compensation to workers who lose their jobs. You report and pay FUTA tax separately from social security and Medicare taxes and withheld income tax. You pay FUTA tax only from your own funds. Employees do not pay this tax or have it withheld from their pay.

☞ Report federal unemployment tax on Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*.

☞ If you qualify, you can use the simpler Form 940–EZ instead. See Publication 15 to find out if you can use this form.

Hiring Employees

When hiring employees, have them fill out Form I-9 and Form W-4. If your employees qualify for advance payments of the earned income credit, they must give you a Form W-5.

Form I-9. You must verify that each new employee is legally eligible to work in the United States. Both you and the employee must complete the Immigration and Naturalization Service (INS) Form I-9, *Employment Eligibility Verification*. You can get the form from INS offices. Call the INS at 1-800-755-0777 for more information about your responsibilities.

Form W-4. Each employee must fill out Form W-4, *Employee's Withholding Allowance Certificate.* You will use the filing status and withholding allowances shown on this form to figure the amount of income tax to withhold from your employee's wages.

Form W-5. An eligible employee who has a qualifying child is entitled to receive the earned income credit (EIC) payments with his or her pay during the year. To get these payments, the employee must give you a properly completed Form W-5, *Earned Income Credit Advance Payment Certificate.* You are required to make advance EIC payments to employees who give you a completed and signed Form W-5. For more information, see Publication 15.

Wage Reporting—Form W-2

After the calendar year is over, you must furnish copies of Form W-2, *Wage and Tax Statement,* to each employee to whom you paid wages during the year. You must also send copies to the Social Security Administration. See *Information Returns,* later, for more information on Form W-2.

Excise Taxes

This section explains the excise taxes you may have to pay and the forms you have to file if you:

- Manufacture or sell certain products,
- Operate certain kinds of businesses, or
- Use various kinds of equipment, facilities, or products.

For more information on excise taxes, see Publication 510.

Form 720. The federal excise taxes reported on Form 720, *Quarterly Federal Excise Tax Return,* consist of several broad categories including:

1) Environmental taxes.
2) Facilities and services taxes.
3) Fuel taxes.
4) Manufacturer's taxes on the sale or use of a variety of different products.
5) Tax on the first retail sale of heavy trucks and trailers.
6) Luxury tax on passenger cars.

Form 2290. There is a federal excise tax on trucks, truck tractors, and buses used on public highways. The tax applies to vehicles having a gross vehicle weight of 55,000 pounds or more. Report the tax on Form 2290, *Heavy Vehicle Use Tax Return.* For more information, see Publication 349, *Federal Highway Use Tax on Heavy Vehicles.*

Form 730. If you are in the business of accepting bets or running a betting pool or lottery, you may be liable for federal excise taxes on wagering. Use Form 730, *Tax on Wagering,* to figure the tax on the bets you receive.

Form 11–C. Use Form 11–C, *Occupational Tax and Registration Return for Wagering,* to register any wagering activity and to pay the occupational tax on wagering.

ATF forms. If you produce, sell, or import guns, tobacco, or alcohol products, or if you manufacture equipment for their production, you may be liable for one or more excise taxes. Report these taxes on forms filed with the Bureau of Alcohol, Tobacco, and Firearms(ATF).

Depositing Taxes

You generally have to deposit employment taxes, certain excise taxes, corporate income tax, and S corporation taxes before you file your return.

Mail or deliver deposits with completed ***deposit coupons*** to an authorized financial institution or a Federal Reserve bank for your area unless you make the deposits electronically as discussed later.

To be on time, mailed deposits must arrive at the depositary by the due date. You may be charged a penalty for not making deposits when due, unless you have reasonable cause.

> ☞ To help ensure proper crediting of your account, include the following on your check or money order:
> Your EIN
> Type of tax
> Tax period for the payment

Deposit coupons. Form 8109, *Federal Tax Deposit Coupon,* is used for depositing taxes. On each coupon, you must show the deposit amount, the type of tax, the period for which you are making a deposit, and your telephone number. Use a separate coupon for each tax and period. You must include a coupon with each deposit you make.

Five to six weeks after you receive your employer identification number (EIN), as discussed earlier, the IRS will send you the coupon book. If you have a deposit due and there is not enough time to obtain a coupon book, blank coupons (Form 8109–B) are available at most IRS offices. You cannot use photocopies of the coupons to make your deposits.

If you have not received your EIN and must make a deposit, mail your payment with an explanation to the IRS Center where you file your return. Make your check or money order payable to the Internal Revenue Service. On the payment, write your name (exactly as shown on Form SS–4), address, kind of tax, period covered, and date you applied for an EIN. Do **not** use Form 8109 in this situation.

Electronic deposit of taxes. Generally, taxpayers whose total deposits of social security and Medicare taxes and withheld income tax during previous years exceeded certain amounts are required to deposit taxes through an electronic funds transfer (EFT) system.

Taxpayers not required to make deposits by EFT may enroll in the system, which will allow tax deposits without coupons, paper checks, or visits to an authorized depositary. For more information, see Publication 15.

Information Returns

If you make or receive payments in your business, you may have to report them to the IRS on information returns. The IRS compares the payments shown on the information returns with each person's income tax return to see if the payments were included in income. You must give a copy of each information return you are required to file to the recipient or payer. In addition to the forms described below, you may have to use other returns to report certain kinds of payments or transactions. For more details on information returns and when you have to file them, see the *Instructions for Forms 1099, 1098, 5498, and W-2G.*

Form 1099–MISC. Use Form 1099–MISC, *Miscellaneous Income,* to report certain payments you make in your trade or business. These payments include:

- Payments of $600 or more for services performed for your business by people not treated as your employees, such as fees to subcontractors, attorneys, accountants, or directors.
- Rent payments of $600 or more, other than rents paid to real estate agents.
- Prizes and awards of $600 or more that are not for services, such as winnings on TV or radio shows.
- Royalty payments of $10 or more.
- Payments to certain crew members by owners or operators of fishing boats. Report payments of proceeds from sale of the catch.

You also use Form 1099-MISC to report sales by you of $5,000 or more of consumer goods to a person for resale anywhere other than in a permanent retail establishment.

Form 8300. You must file Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business,* if you receive more than $10,000 in cash or foreign currency in one transaction, or two or more related business transactions. For more information, see Publication 1544, *Reporting Cash Payments of Over $10,000 (Received in a Trade or Business).*

Form W–2. You must file Form W-2, *Wage and Tax Statement,* to report payments to your employees, such as wages, tips, other compensation, withheld income, social security, and Medicare taxes, and advance earned income credit (EIC) payments. For more information on what to report on Form W-2, see the *Instructions for Form W-2.*

Penalties

To be sure that all taxpayers pay their fair share of taxes, the law provides penalties if you do not file returns or pay taxes as required. Criminal penalties may be imposed for willful failure to file, tax evasion, or making a false statement.

Failure to withhold, deposit, or pay taxes. If you do not withhold income, social security, or Medicare taxes from employees, or if you withhold taxes but do not deposit them or pay them to the IRS, you may be subject to a penalty of the unpaid tax, plus interest. You may also be subject to penalties if you deposit the taxes late. For more information, see Publication 15.

Failure to file information returns. A penalty applies if you do not file information returns by the due date, if you do not include all required information, or if you report incorrect information. For more information, see the *Instructions for Forms 1099, 1098, 5498, and W-2G.*

Failure to furnish correct payee statements. A penalty applies if you do not furnish a required statement to a payee by the required date, if you do not include all required information, or if you report incorrect information. For more information, see the *Instructions for Forms 1099, 1098, 5498, and W-2G.*

Other information reporting penalties. There is a penalty each time you do not comply with certain information reporting requirements by the required date. Most of these requirements concern furnishing and including taxpayer identification numbers on returns, statements, and other documents.

Waiver of penalty. These penalties will not apply if you can show that the failures were due to reasonable cause and not willful neglect.

In addition, there is no penalty for failure to file a *de minimis* (small) number of information returns if you correct the errors by August 1 of the year the returns are due. (A de minimis number of returns is the greater of 10 or ½ of 1% of the total number of returns you are required to file for the year.)

Business Expenses

You can deduct business expenses on your income tax return. To be deductible, a business expense must be both ordinary and necessary. An ***ordinary*** expense is one that is common and accepted in your field of business, trade, or profession. A ***necessary*** expense is one that is helpful and appropriate for your business, trade, or profession. An expense does not have to be indispensable to be considered necessary.

The following are brief explanations of some expenses that are of interest to people starting a business—

Business start-up costs,

Depreciation,

Business use of your home, and

Car expenses.

There are many other expenses that you may be able to deduct. See your form instructions and Publication 535, *Business Expenses*.

Business Start-Up Costs

Business start-up costs are the expenses you incur ***before*** you actually begin business operations. Your business start-up costs will depend on the type of business you are starting. They may include advertising, travel, surveys, and training. These costs are capital expenses. Capital expenses are expenses you deduct over a number of years.

You usually recover costs for a particular asset (such as machinery or office equipment) through depreciation (discussed next). Other start-up costs can be recovered through amortization. This means you deduct them in equal amounts over a period of 60 months or more. If you don't choose to amortize these start-up costs, you generally cannot recover them until you sell or otherwise go out of business.

For more information on business start-up costs, see Publication 535.

Depreciation

If property you acquire to use in your business has a useful life longer than one year, you generally cannot deduct the entire cost as a business expense in the year you acquire it. You must spread the cost over more than one tax year and deduct part of it each year. This method of deducting the cost of business property is called depreciation.

Examples of business property you must depreciate are:

Office furniture,

Building, and

Machinery and equipment.

You can choose to deduct a limited amount of the cost of certain depreciable property in the year you purchase it for use in your business. This deduction is known as the ''section 179 deduction.''

For more information about depreciation and the section 179 deduction, get Publication 946, *How To Depreciate Property*.

Business Use of Your Home

You may be able to deduct the expenses for the part of your home you use for business. The business use of your home ***must meet strict requirements*** before any of these expenses can be taken as business deductions. You can take a limited deduction for its business use if you use part of your home ***exclusively*** and ***regularly***:

1) As the principal place of business for any trade or business in which you engage.
2) As a place to meet or deal with patients, clients, or customers in the normal course of your trade or business, or
3) In connection with your trade or business, if you are using a separate structure that is not attached to your residence.

There are two exceptions to the exclusive use test:

1) The use of part of your home for the storage of inventory, and
2) The use of part of your home as a day-care facility.

If you file Schedule C (Form 1040), use Form 8829, *Expenses for Business Use of Your Home,* to figure your deduction. For more information about business use of your home, get Publication 587, *Business Use of Your Home (Including Use by Day-Care Providers)*.

Car Expenses

If you use your car in your business, you can deduct car expenses. You generally can deduct either your actual expenses or the standard mileage rate.

Actual expenses. If you deduct actual expenses, you can deduct the cost of the following items:

Depreciation	Lease fees	Rental fees
Garage rent	Licenses	Repairs
Gas	Oil	Tires
Insurance	Parking fees	Tolls

If you use your car for both business and personal purposes, you must divide your expenses between business and personal use.

Example. You are the sole proprietor of a flower shop. You drive your van 20,000 miles during the year: 16,000 miles for delivering flowers to customers and 4,000 miles for personal use. You can claim only 80% (16,000 ÷ 20,000) of the cost of operating your van as a business expense.

Standard mileage rate. Instead of figuring actual expenses, you may be able to use the standard mileage rate to figure the deductible costs of operating your car, van, pickup, or panel truck for business purposes. You can use the standard mileage rate only for a car that you own. The standard mileage rate is a specified amount of money you can deduct for each business mile you drive. It is announced annually by the IRS. To figure your deduction, multiply your **business** miles by the standard mileage rate for the year.

If you choose to take the standard mileage rate, you ***cannot*** deduct actual expenses except for business-related parking fees and tolls.

If you want to use the standard mileage rate for a car, you must choose to use it in the first year you place the car in service in business. In later years, you can choose to use the standard mileage rate or actual expenses.

Additional information. For more information about the rules for claiming car expenses, see Publication 917, *Business Use of a Car*.

Recordkeeping

This part explains why you must keep records, what kinds of records you must keep, and how to keep them. It also explains how long you must keep your records for federal tax purposes. A sample recordkeeping system is illustrated at the end of this part.

Why Keep Records?

Everyone in business must keep records. Good records will help you do the following.

Monitor the progress of your business. You need good records to monitor the progress of your business. Records can show whether your business is improving, which items are selling, or what changes you need to make. Good records can increase the likelihood of business success.

Prepare your financial statements. You need good records to prepare accurate financial statements. These include income (profit and loss) statements and balance sheets. These statements can help you in dealing with your bank or creditors.

> ☞ An income statement shows the income and expenses of the business for a given period of time.
>
> ☞ A balance sheet shows the assets, liabilities, and your equity in the business on a given date.

Identify source of receipts. You will receive money or property from many sources. Your records can identify the source of your receipts. You need this information to separate business from nonbusiness receipts and taxable from nontaxable income.

Keep track of deductible expenses. You may forget expenses when you prepare your tax return unless you record them when they occur.

Prepare your tax returns. You need good records to prepare your tax return. These records must support the income, expenses, and credits you report. Generally, these are the same records you use to monitor your business and prepare your financial statements.

Support items reported on tax returns. You must keep your business records available at all times for inspection by the IRS. If the IRS examines any of your tax returns, you may be asked to explain the items reported. A complete set of records will speed up the examination.

Kinds of Records To Keep

Except in a few cases, the law does not require any special kind of records. You may choose any system suited to your business that clearly shows your income.

The business you are in affects the type of records you need to keep for federal tax purposes. You should set up your books using an accounting method that clearly shows your income for your tax year. See *Accounting Method,* earlier. If you are in more than one business, you should keep a complete and separate set of books for each business.

Your books must show your gross income, as well as your deductions and credits. For most small businesses, the business checkbook (discussed later) is the main source for entries in the business books. In addition, you must keep supporting documents, explained next.

Supporting Documents

Purchases, sales, payroll, and other transactions you have in your business will generate supporting documents such as invoices and receipts. These documents contain the information you need to record in your books.

It is important to keep these documents because they support the entries in your books and on your tax return. You should keep them in an orderly fashion and in a safe place.

> ☞ Supporting documents include sales slips, paid bills, invoices, receipts, deposit slips, and canceled checks.
>
> ☞ Keep these documents by year and type of income or expense.

Gross receipts. Gross receipts are the income you receive from your business. You should keep supporting documents that show the amounts and sources of your gross receipts. Examples of documents that show gross receipts include:

- Cash register tapes,
- Bank deposit slips,
- Receipt books,
- Invoices,
- Credit card charge slips, and
- Forms 1099-MISC.

Purchases. Purchases are the items you buy and resell to customers. If you are a manufacturer or producer, this includes the cost of all raw materials or parts purchased for manufacture into finished products. Your supporting documents should show the amount paid and that the amount was for purchases. Examples of documents for purchases include:

- Canceled checks,
- Cash register tape receipts,
- Credit card sales slips, and
- Invoices.

These records will help you determine the value of your inventory at the end of the year. See chapter 7 in Publication 334.

Expenses. Expenses are the costs you incur (other than purchases) to carry on your business. Your supporting documents should show the amount paid and that the amount was for a business expense. Examples of documents for expenses include:

- Canceled checks,
- Cash register tapes,
- Account statements,
- Credit card sales slips,
- Invoices, and
- Petty cash system for *small* cash purchases.

> ☞ A petty cash fund allows you to make small payments without having to write checks for small amounts. Each time you make a payment from this fund, you should make out a petty cash slip and attach it to your receipt as proof of payment.

Travel, transportation, entertainment, and gift expenses. Special recordkeeping rules apply to these expenses. For more information, see Publication 463, *Travel, Entertainment, and Gift Expenses,* and Publication 917, *Business Use of a Car.*

Employment taxes. There are specific employment tax records you must keep. See Publication 15.

Assets. Assets are the property, such as machinery and furniture, that you own and use in your business. You must keep records to verify certain information about your business assets. You need records to figure the annual depreciation and the gain or loss when you sell the assets. Your records should show:

- When and how you acquired the asset,
- Purchase price,
- Cost of any improvements,
- Section 179 deduction taken,
- Deductions taken for depreciation,
- Deductions taken for casualty losses, such as fires or storms,
- How you used the asset,
- When and how you disposed of the asset,
- Selling price, and
- Expenses of sale.

Examples of supporting documents that may show this information include:

- Purchase and sales invoices,
- Real estate closing statements, and
- Canceled checks.

What if I don't have a canceled check? If you do not have a canceled check, you may be able to prove payment with certain financial account statements prepared by financial institutions. These include account statements prepared for the financial institution by a third party. The following is a list of acceptable account statements.

1) An account statement showing a check clearing is accepted as proof if it shows the:
   a) Check number,
   b) Amount,
   c) Payee's name, and
   d) Date the check amount was posted to the account by the financial institution.
2) An account statement showing an electronic funds transfer is accepted as proof if it shows the:
   a) Amount transferred,
   b) Payee's name, and
   c) Date the transfer was posted to the account by the financial institution.
3) An account statement showing a credit card charge (an increase to the cardholder's loan balance) is accepted as proof if it shows the:
   a) Amount charged,
   b) Payee's name, and
   c) Date charged (transaction date).

These account statements must be highly legible.

TIP *Proof of payment of an amount alone does not establish that you are entitled to a tax deduction. You should also keep other documents, such as credit card sales slips and invoices, discussed previously.*

Recording Business Transactions

A good recordkeeping system includes a summary of your business transactions. (Your business transactions are shown on supporting documents just discussed.) Business transactions are ordinarily summarized in books called journals and ledgers. You can buy them at your local stationery or office supply store.

A ***journal*** is a book where you record each business transaction shown on your supporting documents. You may have to keep separate journals for transactions that occur frequently.

A ***ledger*** is a book that contains the totals from all of your journals. It is organized into different accounts.

Whether you keep journals and ledgers and how you keep them depends on the type of business you are in. For example, a recordkeeping system for a small business might include the following:

Business Checkbook

Daily Summary of Cash Receipts

Monthly Summary of Cash Receipts

Check Disbursements Journal

Depreciation Worksheet

Employee Compensation Record

These items, except the checkbook, are illustrated later under *Sample Record System.* The business checkbook is explained next.

- ☞ Daily business records are best.
- ☞ Identify the source of receipts.
- ☞ Record expenses when they occur.
- ☞ Keep complete records on all assets.
- ☞ Keep supporting documents.

Business checkbook. One of the first things you should do when you start a business is open a business checking account. You should keep your business account separate from your personal checking account.

The business checkbook is your basic source of information for recording your business expenses. You should deposit all daily receipts in your business checking account. You should check your account for errors by reconciling it. See *Reconciling the checking account* later.

Consider using a checkbook that allows enough space to identify the source of deposits as business income, personal funds, or loans. You should also note on the deposit slip the source of the deposit and keep copies of all slips.

You should make all payments by check to document business expenses. Write checks payable to yourself only when making withdrawals from your business for personal use. Avoid writing checks payable to cash. If you must write a check for cash to pay a business expense, include the receipt for the cash payment in your records. If you cannot get a receipt for a cash payment, you should make an adequate explanation in your records at the time of payment.

TIP *Use the business account for business purposes only. Indicate the source of deposits and the type of expense in the checkbook.*

Reconciling the checking account. When you receive your bank statement, make sure the statement, checkbook, and books agree. The statement balance may not agree with the balance in your checkbook and books if the statement:

1) Includes bank charges that you did not enter in your books and subtract from your checkbook balance, or
2) Does not include deposits made after the statement date or checks that did not clear your account before the statement date.

By reconciling your checking account, you will:

1) Verify how much money you have in the account,
2) Make sure that your checkbook and books reflect all bank charges and the correct balance in the checking account, and
3) Correct any errors in your bank statement, checkbook, and books.

You should reconcile your checking account each month.

Before you start to reconcile your monthly bank statement, check your own figures. Begin with the balance shown in your checkbook at the end of the previous month. To this balance, add the total cash deposited during the month and subtract the total cash disbursements.

After checking your figures, the result should agree with your checkbook balance at the end of the month. If the result does not agree, you may have made an error in recording a check or deposit. You can find the error by:

1) Adding the amounts on your check stubs and comparing that total with the total in the ‘‘Amount of Check’’ column in your check disbursements journal. If the totals do not agree, check the individual amounts to see if an error was made in your check stub record or in the related entry in your check disbursements journal.
2) Adding the deposit amounts in your checkbook. Compare that total with the monthly total in your cash receipt book, if you have one. If the totals do

not agree, check the individual amounts to find any errors.

If your checkbook and journal entries still disagree, then refigure the running balance in your checkbook to make sure additions and subtractions are correct.

When your checkbook balance agrees with the balance figured from the journal entries, you may begin reconciling your checkbook with the bank statement. Many banks print a reconciliation worksheet on the back of the statement.

To reconcile your account, you:

1) Compare the deposits listed on the bank statement with the deposits shown in your checkbook. Note all differences in the dollar amounts.
2) Compare each canceled check, including both check number and dollar amount, with the entry in your checkbook. Note all differences in the dollar amounts. Mark the check number in the checkbook as having cleared the bank. After accounting for all checks returned by the bank, those not marked in your checkbook are your outstanding checks.
3) Prepare a bank reconciliation. One is illustrated later under *Sample Record System.*
4) Update your checkbook and journals for items shown on the reconciliation as not recorded (such as service charges) or recorded incorrectly.

At this point, the adjusted bank statement balance should equal your adjusted checkbook balance. If you still have differences, check the previous steps to find errors.

Bookkeeping System

You must decide whether to use a single- or a double-entry bookkeeping system. The single-entry system of bookkeeping is the simplest to maintain, but it may not be suitable for everyone. You may find the double-entry system better because it has built-in checks and balances to assure accuracy and control.

Single-entry. A single-entry system is based on the income statement (profit or loss statement). It can be a simple and practical system if you are starting a small business. The system records the flow of income and expenses through the use of:

1) A daily summary of cash receipts, and
2) Monthly summaries of cash receipts and disbursements.

Double-entry. A double-entry bookkeeping system uses journals and ledgers. Transactions are first entered in a journal and then posted to ledger accounts. These accounts show income, expenses, assets (property a business owns), liabilities (debts of a business), and net worth (excess of assets over liabilities). You close income and expense accounts at the end of each tax year. You keep asset, liability, and net worth accounts open on a permanent basis.

In the double-entry system, each account has a left side for debits and a right side for credits. It is self-balancing because you record every transaction as a debit entry in one account and as a credit entry in another. An example of a journal entry showing a payment of rent in October is shown next.

General Journal

Date	Description of Entry	Debit	Credit
Oct. 5	Rent expense	780.00	.
	Cash	.	780.00
		.	.
		.	.

Under this system, the total debits must equal the total credits after you post the journal entries to the ledger accounts. If the amounts do not balance, you have made an error and you must find and correct it.

Computerized System

There are computer software packages that you can use for recordkeeping. They can be purchased in many retail stores. These packages are very useful and relatively easy to use; they require very little knowledge of bookkeeping and accounting.

If you use a computerized system, you must be able to produce legible records from the system to provide the information needed to determine your correct tax liability.

You must also keep all machine-sensible records and a complete description of the computerized portion of your accounting system. This documentation must be sufficiently detailed to show the following:

1) Applications being performed,
2) Procedures used in each application,
3) Controls used to ensure accurate and reliable processing, and
4) Controls used to prevent the unauthorized addition, alteration, or deletion of retained records.

See Revenue Procedure 91–59, printed in Cumulative Bulletin 1991–2 on page 841 for more information.

Microfilm

Microfilm and microfiche reproductions of general books of accounts, such as cash books, journals, voucher registers, and ledgers, are accepted for recordkeeping purposes if they comply with Revenue Procedure 81–46, printed in Cumulative Bulletin 1981–2 on page 621.

Table 3. **Period of Limitations**

In the following situations,	The period of limitationsis:
1. You owe additional tax and situations (2), (3), and (4), below, do not apply to you.	3 years
2. You do not report income that you should report, and it is more than 25% of the gross income shown on your return.	6 years
3. You file a fraudulent income tax return.	No limit
4. You do not file a return.	No limit
5. You file a claim for credit or refund after you file your return.*	Later of: 3 years, or 2 years after tax was paid
6. Your claim is due to a bad debt deduction.	7 years
7. Your claim is due to a loss from worthless securities.	7 years

* Individuals file a claim for credit or refund on Form 1040X.

How Long To Keep Records

You must keep your records as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep records that support an item of income or deduction on a return until the period of limitations for that return runs out.

The period of limitations is the period of time in which you can amend your return to claim a credit or refund, or the IRS can assess additional tax. Table 3 contains the period of limitations that apply to income tax returns. Unless otherwise stated, the years refer to the period after the return was filed. Returns filed before the due date are treated as filed on the due date.

TIP *Keep copies of your filed tax returns. They help in preparing future tax returns and making computations if you later file an amended return.*

Employment taxes. If you have employees, you must keep all employment tax records for at least 4 years after the date the tax becomes due or is paid, whichever is later.

Assets. Keep records relating to property until the period of limitations expires for the year in which you dispose of the property in a taxable disposition. You must keep these records to figure any depreciation, amortization, or depletion deduction, and to figure your basis for computing gain or loss when you sell or otherwise dispose of the property.

Generally, if you received property in a nontaxable exchange, your basis in that property is the same as the basis of the property you gave up. You must keep the records on the old property, as well as on the new property, until the period of limitations expires for the year in which you dispose of the new property in a taxable disposition.

Records for nontax purposes. When your records are no longer needed for tax purposes, do not discard them until you check to see if you have to keep them longer for other purposes. For example, your insurance company or creditors may require you to keep them longer than the IRS does.

Sample Record System

This example illustrates a single-entry system used by Henry M. Brown, who is the sole proprietor of a small automobile body shop. Henry uses part-time help, has no inventory of items held for sale, and uses the cash method of accounting.

These sample records should ***not*** be viewed as a recommendation of how to keep your records. They are intended to show how one business keeps its records.

1) Daily Summary of Cash Receipts

This summary is a record of cash sales for the day. It accounts for cash over the amount in the Change and Petty Cash Fund at the beginning of the day.

Henry takes the Cash Sales entry from his cash register tape. If he had no cash register, he would simply total his cash sale slips and any other cash received that day.

He enters the total receipts ($267.80), including cash sales ($263.60) and sales tax ($4.20) for January 3, from the *Daily Summary of Cash Receipts* in the *Monthly Summary of Cash Receipts.*

Petty cash fund. Henry uses a petty cash fund to make small payments without having to write checks for small amounts. Each time he makes a payment from this fund, he makes out a petty cash slip and attaches it to his receipt as proof of payment. He sets up a fixed amount ($50) in his petty cash fund. The total of the unspent petty cash and the amounts on the petty cash slips should equal the fixed amount of the fund.

When the totals on the petty cash slips approach the fixed amount, he brings the cash in the fund back to the fixed amount by writing a check to ‘‘Petty Cash’’ for the total of the outstanding slips. (See the *Check Disbursements Journal* entry for check number 92.) This restores the fund to its fixed amount of $50. He then summarizes the slips and enters them in the proper columns in the monthly check disbursements journal.

2) Monthly Summary of Cash Receipts

This shows the income activity for the month. Henry carries the total monthly net sales ($4,865.05) to his *Annual Summary*.

To figure total monthly net sales, Henry reduces the total monthly receipts by the sales tax imposed on his customers and turned over to the state. He cannot take a deduction for sales tax turned over to the state because he only collected the tax. He does not include the tax in his income.

3) Check Disbursements Journal

Henry enters checks drawn on the business checking account in the *Check Disbursements Journal* each day. All checks are prenumbered and each check number is listed and accounted for in the column provided in the journal.

Frequent expenses have their own headings across the sheet. He enters in a separate column expenses that require comparatively numerous or large payments each month, such as materials, gross payroll, and rent. Under the general account column, he enters small expenses that normally have only one or two monthly payments, such as licenses and postage.

Henry does not pay personal or nonbusiness expenses by checks drawn on the business account. If he did, he would record them in the journal, even though he could not deduct them as business expenses.

Henry carries the monthly total of materials ($1,083.50) to the *Annual Summary.* Similarly, he enters monthly expenses for telephone, truck, auto, etc., in the appropriate columns of this summary.

4) Employee Compensation Record

This record shows the number of hours his employee worked in a pay period and the employee’s total pay for the period. It also shows the deductions Henry withheld in figuring the employee’s net pay.

The employee compensation record also shows the monthly gross payroll, which is carried to the *Annual Summary*.

5) Annual Summary

This annual summary of monthly cash receipts and expense totals provides the final amounts to enter on Henry’s tax return. He figures the annual summary from the total of monthly cash receipts items, as shown on the *Monthly Summary of Cash Receipts.* He figures the monthly expenses from the *Check Disbursements Journal.* As in the journal, he keeps each major expense in a separate column.

Henry enters the cash receipts total ($47,440.95) from the annual summary in Part I of Schedule C (not illustrated).

He carries the total for materials ($10,001.00) from the annual summary to Part II.

There are no inventories of materials and supplies in this example. Henry buys parts and supplies on a per-job basis. A business that keeps materials and supplies on hand, unless they are incidental and records of use are not kept, must complete the inventory lines in Part III of Schedule C.

Henry enters annual totals for interest, rent, taxes, and wages on the appropriate lines in Part II of Schedule C. The total for taxes and licenses includes the employer’s share of social security and Medicare taxes, and the business license fee. He enters the total of other annual business expenses on the ‘‘other expenses’’ line of Schedule C.

6) Depreciation Worksheet

Another major item is the depreciation allowed on assets used in Henry’s business. The sample depreciation worksheet shows examples of items depreciated using the modified accelerated cost recovery system (MACRS). Depreciation is discussed in Publication 946.

Henry must take depreciation in the year it is allowable. He cannot deduct in the current year the allowable depreciation he did not take in a prior year. He must amend the prior year’s tax return to take the depreciation deduction.

He deducts $17,500 of the cost of certain depreciable property purchased and placed in service in his trade or business during the year. This is the ‘‘section 179 deduction.’’ The section 179 deduction is discussed in Publication 946.

The amount of depreciation Henry can claim for the tax year is shown on his depreciation worksheet. He uses the worksheet to complete Form 4562, *Depreciation and Amortization,* (not illustrated).

7) Bank Reconciliation

Henry reconciles his checkbook with his bank statement and prepares a bank reconciliation for January as follows.

1) Henry begins by entering his bank statement balance.
2) Henry compares the deposits listed on the bank statement with deposits shown in his checkbook. Two deposits shown in his checkbook—$701.33 and $516.08—were not on his bank statement. He enters these two amounts on the bank reconciliation. He adds them to the bank statement balance of $1,458.12 to arrive at a subtotal of $2,675.53.
3) After comparing each canceled check with his checkbook, Henry found four outstanding checks

totaling $526.50. He subtracts this amount from the subtotal in (2) above. The result of $2,149.03 is the adjusted bank statement balance.

4) Henry enters his checkbook balance on the bank reconciliation.
5) He discovered that he mistakenly entered a deposit of $600.40 in his checkbook as $594.40. He adds the difference ($6.00) to the checkbook balance of $2,153.03. There was a $10.00 bank service charge on his bank statement that he subtracts from the checkbook balance. The result is the adjusted checkbook balance of $2,149.03. This equals his adjusted bank statement balance computed in (3) earlier.

The only book adjustment Henry needs to make is to the *Check Disbursements Journal* for the $10 bank service charge. He does not need to adjust the *Monthly Summary of Cash Receipts* because he correctly entered the January 8 deposit of $600.40 in that record.

1. Daily Summary of Cash Receipts

Date January 3, 19—

Cash sales		263.60
Sales tax		4.20
TOTAL RECEIPTS		267.80
Cash on hand		
Cash in register (including unspent petty cash)		
Coins	23.75	
Bills	143.00	
Checks	134.05	
TOTAL CASH IN REGISTER		300.80
Add: Petty cash slips		17.00
TOTAL CASH		317.80
Less: Change and petty cash		
Petty cash slips	17.00	
Coins and bills (unspent petty cash)	33.00	
TOTAL CHANGE AND PETTY CASH FUND		50.00
TOTAL CASH RECEIPTS		267.80

2. Monthly Summary of Cash Receipts

Year 19— Month January

Day	Net Sales	Sales Tax	Daily Receipts	Deposit
3	263.60	4.20	267.80	.
4	212.00	3.39	215.39	.
5	194.40	3.10	197.50	680.69
6	222.40	3.54	225.94	.
7	231.15	3.68	234.83	.
8	137.50	2.13	139.63	600.40
10	187.90	2.99	190.89	.
11	207.56	3.31	210.87	401.76
12	128.95	2.05	131.00	.
13	231.40	3.77	235.17	.
14	201.28	3.21	204.49	.
15	88.01	1.40	89.41	660.07
17	210.95	3.36	214.31	.
18	221.80	3.53	225.33	439.64
19	225.15	3.59	228.74	.
20	221.93	3.52	225.45	.
21	133.53	2.13	135.66	589.85
22	130.84	2.08	132.92	.
24	216.37	3.45	219.82	352.74
25	220.05	3.50	223.55	.
26	197.80	3.15	200.95	.
27	272.49	4.34	276.83	701.33
28	150.64	2.40	153.04	.
29	224.05	3.56	227.61	.
31	133.30	2.13	135.43	516.08
TOTALS	4,865.05	77.51	4,942.56	4,942.56

3. Check Disbursements Journal

Year 19— Month January

Day	Paid To	Check #	Amount of Check	Materials	Gross Payroll	Federal Withheld Income Tax	FICA Social Security Reserve	FICA Medicare Reserve
3	Dale Advertising	74	85.00	.	.	.	.	.
4	City Treasurer	75	35.00	.	.	.	.	.
4	Auto Parts, Inc.	76	203.00	203.00	.	.	.	.
4	John E. Marks	77	214.11	.	260.00	(20.00)	(16.12)	(3.77)
6	Henry Brown	78	250.00	.	.	.	.	.
6	Mike's Deli	79	36.00	.	.	.	.	.
6	Joe's Service Station	80	74.50	29.50	.	.	.	.
6	ABC Auto Paint	81	137.50	137.50	.	.	.	.
7	Henry Brown	82	225.00	.	.	.	.	.
14	Telephone Co.	83	27.00	.	.	.	.	.
15	National Bank (Tax deposit)	84	119.56	.	.	40.00	32.24	7.54
18	National Bank	85	90.74	.	.	.	.	.
18	Auto Parts, Inc.	86	472.00	472.00	.	.	.	.
18	Henry Brown	87	275.00	.	.	.	.	.
18	John E. Marks	88	214.11	.	260.00	(20.00)	(16.12)	(3.77)
21	Electric Co.	89	175.30	.	.	.	.	.
21	M. B. Ignition	90	66.70	66.70	.	.	.	.
21	Baker's Fender Co.	91	9.80	9.80	.	.	.	.
21	Petty cash	92	17.00	15.00	.	.	.	.
21	Henry Brown	93	225.00	.	.	.	.	.
25	Baker's Fender Co.	94	150.00	150.00	.	.	.	.
25	Enterprise Properties	95	300.00	.	.	.	.	.
25	State Treasurer	96	12.00	.	.	.	.	.
25	State Treasurer	97	65.08	.	.	.	.	.
			3,479.40	1,083.50	520.00	-0-	-0-	-0-
	Bank service charge		10.00	.	.	.	.	.
TOTALS			3,489.40	1,083.50	520.00	-0-	-0-	-0-

3. Check Disbursements Journal *(Continued)*

State Withheld Income Tax	Employer's FICA Tax	Electric	Interest	Rent	Telephone	Truck/ Auto	Drawing	General Accounts	
								Advertising	85.00
								License	35.00
(6.00)									
							250.00		
								Shop Holiday Party	36.00
						45.00			
							225.00		
					27.00				
	39.78								
			18.09					Loan	72.00
							275.00		
(6.00)									
		175.30							
								Postage	2.00
							225.00		
				300.00					
12.00									
								Sales Tax	65.00
-0-	39.78	175.30	18.09	300.00	27.00	45.00	975.00		295.00
									10.00
-0-	39.78	175.30	18.09	300.00	27.00	45.00	975.00		305.00

4. Employee Compensation Record

Name John E. Marks ☐ Full Time Soc. Sec. No. 567-00-8901

Address 1 Elm St., Newark, NJ 07101 ☒ Part Time Date of Birth 12-21-65

Phone 555-6075 No. of Exemptions 1/Single

		Hours Worked		Earnings			Deductions				
Pay Period Ending	Date Paid	S M T W T F S S M T W T F S	Total Regular Hours	Overtime	Regular Rate	Overtime Rate	Total	Social Security	Medicare	Federal Income Tax	State Income Tax	Net Pay
1-1	1-4	5 555 5 546	40		$6.50	-	$260.00	$16.12	$3.77	$20.00	$6.00	$214.11
1-15	1-18	444442 43443	40		6.50	.	260.00	16.12	3.77	20.00	6.00	214.11
			80		.	.	$520.00	$32.24	$7.54	$40.00	$12.00	$428.22
					.	.	.	.	.	.	.	.
		QUARTERLY TOTALS			.	.	$6262.40	$78.23	$18.31	$100.00	$30.00	$1035.86

5. Annual Summary

Month	Cash Receipts	Materials/ Supplies	Gross Payroll	FICA Taxes	Bank Charges	Electric	Interest	Insurance	Rent	Telephones	Truck/ Auto	Advertising	Office Expenses	Taxes/ Licenses	Misc.
January	$4,865.05	$1083.50	$520.00	$39.78	$10.44	$175.80	$18.09	.	$300.00	$27.00	$45.00	$85.00	$36.00	$100.08	$38.00
February	3,478.32	874.13	235.40	17.60	7.12	153.10	18.09	210.00	300.00	21.50	28.50	.	.	.	.
March	3,942.00	724.96	507.00	38.00	11.25	145.81	18.09	.	300.00	32.10	51.30	.	.	.	.
December	3,656.52	609.38	510.00	39.78	10.00	169.00	18.09	.	300.00	23.13	37.62	.	9.00	.	71.97
TOTALS	$43,440.95	$10,001.00	$5,734.00	$408.09	$92.50	$1,692.37	$217.08	$420.00	$3,600.00	$324.09	$571.96	$85.00	$40.00	$218.00	$344.00

6. Depreciation Worksheet

Description of Property	Date Placed in Service	Cost or Other Basis	Business/ Investment Use %	Section 179 Deduction	Depreciation Prior Years	Basis for Depreciation	Method/ Convention	Recovery Period	Rate or Table %	Depreciation Deduction
Equipment - Transmission Jack	1-3	1,366	100 %	—	—	1,366	200 DB/HY	7	14.29%	$175
Pickup Truck (used)	1-3	3,500	100 %	2,000	—	1,500	200 DB/HY	5	20 %	300
Heavy Duty Tow Truck	1-3	18,000	100%	15,500	—	2,500	200 DB/HY	5	20 %	500
Equipment - Engine Hoist	1-3	1,600	100 %	—	—	1,600	200 DB/HY	7	14.29 %	229
										$1,224

7. Bank Reconciliation as of

Date January 31, 19—

Closing balance shown on bank statement 1,458.12

Add deposits not credited:

1/28	701.33
1/31	516.08

TOTAL DEPOSITS NOT CREDITED 1,217.41

Subtotal 2,675.53

Subtract outstanding checks:

No.	
90	66.70
91	9.80
94	150.00
95	300.00

TOTAL OUTSTANDING CHECKS: 526.50

Adjusted balance per bank statement 2,149.03

Balance shown in checkbook 2,153.03

Add: Deposit of $600.40 for 1/8 entered as $594.40 (difference) 6.00

2,159.03

Subtract: Bank service charge 10.00

Adjusted checkbook balance 2,149.03