Small Business /Self Employed Recordkeeping

http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Recordkeeping

Why should I keep records?

Everyone in business must keep records. Keeping good records is very important to your business. Good records will help you do the following:

- Monitor the progress of your business
- Prepare your financial statements
- Identify source of receipts
- Keep track of deductible expenses
- Prepare your tax returns
- Support items reported on tax returns

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 and help you manage your business.

- 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 return

You need good records to prepare your tax returns. 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 statement.

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.

What kind of records should I keep?

You may choose any recordkeeping system suited to your business that clearly shows your income and expenses. Except in a few cases, the law does not require any special kind of records. However, the business you are in affects the type of records you need to keep for federal tax purposes. Your recordkeeping system should also include a summary of your business transactions. This summary is ordinarily made in your business books (for example, accounting journals and ledgers). Your books must show your gross income, as well as your deductions and credits. For most small businesses, the business checkbook is the main source for entries in the business books.

Some businesses choose to use electronic accounting software programs to capture and organize their records. In some situations, you will still need to keep original documentation for certain items. The software program you choose should meet the same basic recordkeeping principals mentioned above.

Supporting Business Documents

Purchases, sales, payroll, and other transactions you have in your business will generate supporting documents such as invoices and receipts. Supporting documents include sales slips, paid bills, invoices, receipts, deposit slips, and canceled checks. 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. For instance, organize them by year and type of income or expense. For more detailed information refer to Publication 583, Starting a Business and Keeping Records.

The following are some of the types of records you should keep:

- **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. Documents for gross receipts include the following:
  - Cash register tapes
  - Bank deposit slips
  - Receipt books
  - Invoices
  - Credit card charge slips
  - Forms 1099-MISC

- **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. Documents for purchases include the following:
  - Canceled checks
  - Cash register tape receipts
  - Credit card sales slips
  - Invoices

- **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. Documents for expenses include the following:
  - Canceled checks
  - Cash register tapes
  - Account statements
  - Credit card sales slips
  - Invoices
  - Petty cash slips for small cash payments

- **Travel, Transportation, Entertainment, and Gift Expenses**
  If you deduct travel, entertainment, gift or transportation expenses, you must be able to prove (substantiate) certain elements of expenses. For additional information on how to prove certain business expenses, refer to Publication 463, Travel, Entertainment, Gift, and Car Expenses.

- **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 compute the annual depreciation and the gain or loss when you sell the assets. Documents for assets include the following:
  - When and how you acquired the assets.
  - Purchase price
  - Cost of any improvements.
  - Section 179 deduction taken.
  - Deductions taken for depreciation.
  - Deductions taken for casualty losses, such as losses resulting from fires or storms.
  - How you used the asset.
    When and how you disposed of the asset.
  - Selling price.
  - Expenses of sale.

  The following documents may show this information.
  - Purchase and sales invoices.
  - Real estate closing statements.
  - Canceled checks.

- **Employment taxes**
  There are specific employment tax records you must keep. Keep all records of employment for at least four years. For additional information, refer to Recordkeeping for Employers andPublication 15, Circular E Employers Tax Guide.

How long should I keep records?

The length of time you should keep a document depends on the action, expense, or event the document records. Generally, you must keep your records that support an item of income or deductions on a tax 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 tax return to claim a credit or refund, or that the IRS can assess additional tax. The below information contains the periods 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.
Note: Keep copies of your filed tax returns. They help in preparing future tax returns and making computations if you file an amended return.

1. You owe additional tax and situations (2), (3), and (4), below, do not apply to you; keep records for 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; keep records for 6 years.
3. You file a fraudulent return; keep records indefinitely.
4. You do not file a return; keep records indefinitely.
5. You file a claim for credit or refund* after you file your return; keep records for 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later.
6. You file a claim for a loss from worthless securities or bad debt deduction; keep records for 7 years.

7. Keep all employment tax records for at least 4 years after the date that the tax becomes due or is paid, whichever is later.

The following questions should be applied to each record as you decide whether to keep a document or throw it away.

Are the records connected to 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 the 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 bases of the property you gave up, increased by any money you paid. 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.

What should I do with my 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.

Employment Tax Recordkeeping

Internal Revenue Service (IRS)

Keep all records of employment taxes for at least four years after filing the 4th quarter for the year. These should be available for IRS review. Records should include:

- Your employer identification number.
- Amounts and dates of all wage, annuity, and pension payments.
- Amounts of tips reported.
- The fair market value of in-kind wages paid.
- Names, addresses, social security numbers, and occupations of employees and recipients.
- Any employee copies of Form W-2 that were returned to you as undeliverable.
- Dates of employment.
- Periods for which employees and recipients were paid while absent due to sickness or injury and the amount and weekly rate of payments you or third-party payers made to them.
- Copies of employees' and recipients' income tax withholding allowance certificates (Forms W-4, W-4P, W-4S, and W-4V).
- Dates and amounts of tax deposits you made.
- Copies of returns filed.
- Records of allocated tips.
- Records of fringe benefits provided, including substantiation.

Burden of Proof

The responsibility to prove entries, deductions, and statements made on your tax returns is known as the burden of proof. You must be able to prove (substantiate) certain elements of expenses to deduct them. Generally, taxpayers meet their burden of proof by having the information and receipts (where needed) for the expenses. You should keep adequate records to prove your expenses or have sufficient evidence that will support your own statement. You generally must have documentary evidence, such as receipts, canceled checks, or bills, to support your expenses. Additional evidence is required for travel, entertainment, gifts, and auto expenses.