

An Overview of Recordkeeping for Sole Proprietors

(and a companion spreadsheet for tracking income & expenses)

Here's a guide to help you track your business income and expenses. It is designed to help you decide which category to choose for each item so it will correspond to the what eventually flows to your tax return's Schedule C. And, it all ties in with a spreadsheet that you can use to record all your income & expense items.

Always remember that you must keep records like receipts and bank statements to back up the expenses you claim. If you want to learn more about record keeping requirements in greater detail, please take a look at IRS Publications 583 and 463. These publications, along with all the other forms, schedules & instructions I mention here, can be easily viewed or downloaded using links at this website or from www.irs.gov.

To use the spreadsheet, you'll need to have Microsoft Excel, Apple iWork Numbers or some other spreadsheet application that can open one of these file formats. I've created the Excel version using Apache Open Office, which is a free, Windows-based online office suite available from Oracle at www.openoffice.org.

Please note that while most of the cells in the Excel version of the spreadsheet are protected from your editing, Numbers does not have an feature that allows locking of individual cells. So, if you're a Mac user, be aware that you can inadvertently edit cells and create referencing errors.

Once you open the spreadsheet file, you'll either see four tabs at the bottom (Excel version) or four worksheet pages on the left side (Numbers version):

- "Income and Expenses" is for tracking your individual income and expense transactions. There are 1,000 rows formatted for data entry, which should be plenty.
- "Mileage" is for recording your business-related mileage.
- The third sheet page is for recording Home Office expenses.
- "YTD by Category" is a summation of the items entered on the three prior sheets.

Income & Expenses

To track your income and expenses, list each item/transaction separately on the "Income and Expenses" tab. If you buy several different things at a store, group them by category rather than lumping them together. Put the date in column A. Choose a category for each item from the pull-down menu in column B, using the descriptions below as a guide. *If you are a Numbers user, Column B always shows "Income" as the category until you click on that cell, at which time a drop down menu appears.*

If you choose "Other Expenses", then column C will change from black (or from blue, in Numbers) to white. You can then type in a descriptive subcategory for that item in column C. Always try to use the same subcategories for similar items as much as possible, as it will make tax time easier. You can use the other categories as examples for how broad/narrow to make your subcategories.

In column D, enter a more detailed description of the item so you will be able to match it up to a bank statement or receipt if necessary. Finally, enter the total in column E if it's income or column F if it's an expense. The final YTD Total column will update automatically.

An example of what this sheet page might look like is:

Date	Category	Subcategory for "Other Expenses"	Description	Income	Expense	YTD Total
1/12/15	Income		Invoice # 2345	\$699.00		\$699.00
1/14/15	Insurance (other than auto/life/health)		The Hartford – liability renewal		\$425.00	\$274.00
1/14/15	Advertising/Marketing		business cards		\$29.00	\$245.00
1/18/15	Income		Invoice # 2346	\$550.00		\$795.00
1/20/15	Depreciation & Section 179		iPhone 6s		\$649.00	\$146.00
1/21/15	Office Expenses		Phone car charger/case		\$49.98	\$96.02
1/21/15	Income		refund on car charger	\$24.99		\$121.01
1/23/15	Other Expenses	Research	Books		\$19.50	\$101.51
1/25/15	Meals & Entertainment @ 50%		lunch w/ Jerry M.		\$35.00	\$66.51

and, the corresponding YTD by Category sheet would be as follows:

Income		\$1,273.99	
Advertising/Marketing		\$29.00	
Commissions & Fees Paid		\$0.00	
Continuing Education		\$0.00	
Contract Labor/Outside Services		\$0.00	
Depreciation & Section 179		\$649.00	
Dues & Subscriptions		\$0.00	
Insurance (other than auto/life/health)		\$425.00	
Interest Paid		\$0.00	
Legal & Professional Services		\$0.00	
Office Expenses		\$49.98	
Parking & Tolls		\$0.00	
Postage & Shipping		\$0.00	
Rent/Lease (vehicles, machinery, or equipment)		\$0.00	
Rent/Lease (other business property)		\$0.00	
Repairs & Maintenance		\$0.00	
Supplies		\$0.00	
Taxes & Licenses		\$0.00	
Telephone	Business %	75%	\$0.00
Travel		\$0.00	
Meals & Entertainment @ 50%		\$17.50	
Utilities		\$0.00	
Other Expenses		\$19.50	
Car & Truck Expenses – Standard Mileage Rate		\$0.00	
Home Office Deduction		\$0.00	
TOTAL INCOME		\$1,273.99	
TOTAL EXPENSES			<u>\$1,189.98</u>
PROFIT(LOSS)		\$84.01	

Category Descriptions

Income – Assign this category to all sources of income, and use the “Description” field as necessary.

Advertising/Marketing – Include advertising and marketing costs like business cards, website design and/or hosting, print or media ads, mailers, brochures, signs, pens, and give-away items with your name, etc. Basically, any expense incurred to promote your business.

Commissions & Fees – Sales commissions, finder’s fees, bank charges, merchant fees, etc.

Continuing Education – If you take classes/workshops, do online courses or attend

seminars/conventions that are either required for your existing work or enhance your knowledge in your existing work, record the costs here. Related travel and meals expenses should be entered under those categories. **Expenses incurred to train you in a new field of work do not qualify here.**

Contract Labor/Outside Services – If you pay an outside contractor to handle something for your business, put that expense in this category.

Remember - If you pay a contractor more \$600 or more over the course of the year, you will need to file a 1099 form with IRS to report their income and to back up your claiming it as an expense. This is an area that IRS has really begun to focus on, and you can learn more here: <http://steves-tax.com/all-about-1099-misc-forms-filings/>.

Oregon taxpayers are required to report such payments separately to the state through the iWire system:

<https://www.oregon.gov/dor/programs/businesses/pages/iwire.aspx>

Depreciation & Section 179 Expense Deduction – A business item costing \$200 or more is considered a capital asset to be depreciated over a set number of years (usually five or seven). You generally can elect to either write off some of the cost each year or expense it all at once. Either way, the asset must be tracked over the assigned lifetime, as there may be a taxable business gain or loss when it is disposed of. This can also apply to equipment you already own personally and then decide to use in your business. Be sure to keep dated purchase receipts of what you buy. There is an election that can be made to increase the \$200 to \$2,500 for many, though not all, items, which can be made when completing the Tax Organizer I send out.

Dues & Subscriptions – Professional dues and membership fees go here, along with business-related subscription costs.

Insurance – This covers insurance for your business and for the operation of your business – not your personal insurance. Examples would be liability, fire, theft, robbery, flood, hail, etc. It doesn't include your own health insurance, which is either an adjustment to income or an itemized deduction. It doesn't include automobile insurance when you use the standard mileage rate, and it never includes life insurance.

Interest Paid – This includes interest on loans to finance your business, credit card interest and fee charges for business expenses, and interest on a loan for property used in your business. For interest on an auto loan, see the discussion of those expenses later in this document.

Legal & Professional Services – Fees for tax advice, tax preparation, legal advice, and so on go here. For tax prep you can only include the cost of preparing the forms and accompanying worksheets that are directly related to your business. I will always apportion my fees among the various schedules when I prepare your tax returns.

Office Expenses – This covers office supplies for your business: ink, paper, toner, pens, staplers and staples, paper clips, folders, incidental postage, and so on.

Parking & Tolls – The only other auto-related expenses you can deduct if you use the standard mileage rate.

Postage & Shipping – This could be wrapped up under Office Expenses, but if you maintain an inventory and mail or ship a lot of stuff, track it separately here.

Rent or Lease – You have two choices here. One is for leasing “vehicles, machinery, equipment” and an option for “other” (such as an office rental, storage unit or anything else that doesn’t fit in the first choice).

Repairs & Maintenance – Incidental costs of labor, supplies, and other items. that do not increase the value or life of your business property.

Supplies – Use this to cover other small, consumable items you use in the business that aren't truly office expenses, such as a contractor's screws & nails or a painter's paint & brushes.

Taxes & Licenses – This category includes local business taxes, sales tax, real estate tax, personal property taxes on business assets, licenses and regulatory fees for your business.

Telephone – Most likely, your cell phone costs. And, please specify a percentage of how much you use your phone for business - It isn't 100% - ever!

Travel – Travel means you were away for business purposes at least overnight. It applies to something like a convention, seminar, or visiting a client, as long as it's business related. If you mix business and vacation on the same trip, your cost of getting there is deductible if at least 50% of your travel days involve business- activity. Otherwise, you can only deduct local travel (car rental, taxi, etc.) and lodging expenses incurred on your business days.

Deductible Meals – These must have a business related purpose, and you must keep notes with attendee names and what was discussed. Although you will record the full amount of these expenses here, please be aware that only 50% (80% for truckers/transportation workers) will ultimately be deductible. The "Year to Date Totals" tab reflects the 50% adjustment.

As an alternative to keeping a record of what you spend on meals and incidental expenses while traveling, you can instead use government per diem rates, which range from \$55 to \$76 per day, depending on location. This usually is more favorable, unless you are really running up big restaurant bills. To use per diem instead of actual expenses, you need records as to where you traveled to and when. Find links to per diem rates here: <http://steves-tax.com/for-sole-proprietors/>

Utilities – You can only deduct utilities directly related to your business. If you rent an office, or use a separately metered structure on your property, gas, electric, etc. will go here. There's a separate spreadsheet tab for home office expenses.

Other Expenses – Anything that doesn't fit in one of the above categories goes here. Assign a subcategory that is not too broad or too specific.

Please Note – The categories I've described above differ a bit from those that actually appear on Schedule C. I've included some additional categories that you can choose from the drop down menu (like Continuing Education). Although these would be considered "Other Expenses", when I come across items that get used frequently, I find it easier to work with them at year-end if they are set up as separate categories.

Car & Truck Expenses

You can either deduct actual costs for operating your car or truck in your business, or you can take the standard mileage rate (\$0.575/mile in 2020). If you choose standard mileage, then the only line items to enter on the spreadsheet are your parking fees and tolls. Whatever approach you take, your actual mileage, both for business purposes and in total, must be tracked either on the spreadsheet page here or in your personal log.

This spreadsheet assumes that the standard mileage rate will be used. If you want to deduct actual costs, then you need to separately track the cost of gas, oil, repairs, insurance, tires, repairs and deductible licensing fees. Generally, the big deduction here is depreciation (calculated outside of this spreadsheet), but you must use your vehicle for business at least 50% of the time to claim this. Hence, for most people, it's simpler and better to just go with the standard mileage rate.

Please note that if you don't use the standard mileage rate in the initial year of service for your vehicle, you must use actual expenses in each ensuing year. If you use the standard mileage rate in year #1, you can switch back and forth in later years.

Mileage

Tracking your mileage is straightforward. Since you need to know your total miles driven for all purposes, you can enter the starting and ending mileage readings in the first two cells.

Record each trip separately. You can combine round trips into a single entry if you like – just make it clear in the description. Enter the date in column A. Enter the total mileage driven for business purposes in column B. Enter your destination in column C and make it specific enough that you can recalculate the mileage in the future if needed. It's a good idea to enter the starting point and destination to make this easy.

Finally, include the business purpose of the trip in column D. It doesn't need to be extremely detailed, but it needs to be clear enough to show that it's business related. This will vary depending on your particular business, but it should be pretty simple to figure out. Don't forget to include trips to pick up supplies for your business. You don't have to be generating income to count the trip.

Business Use of Your Home (Home Office Expenses)

If you qualify, you can deduct expenses for the business use of your home. To do this, the area of your home must be exclusively used for business. If you run an office out of spare bedroom that guests stay in from time to time, then measure the portion of that room that is used for business purposes.

The expense items to keep track of are: mortgage interest & real estate taxes (if you own your own home), or rent paid; homeowner's/renter's insurance premiums; utilities (water, electric, trash), internet (if used for business purposes); telephone (again, if business-related, like for faxing); repairs & maintenance. If you make improvements to your home and, in particular, if those improvements are directly related to your home office, keep good records here as well. Aside from direct home expenses for your business, your available deduction will be pro-rated by the ratio of size of your exclusive office space divided by your total home living space. And, there are other factors that may limit your deduction.

There is also a simplified "safe harbor" method that is available here. You can claim \$5 per square foot (up to a maximum of \$1,500) as your home office expense deduction. And, you won't have to keep track of anything I mentioned above. You can switch between actual expenses and the safe harbor method from year to year. Please note that if you use the standard deduction on your federal return, you can't also take a deduction for mortgage interest and property taxes apportioned to your home office. Hence, the trend here is to use the safe harbor in these situations.

Using This Spreadsheet for Your Taxes

By using this spreadsheet to track your income and expenses by category and forward it to me with your other tax documents, you'll make my work much faster & easier. Remember that you want to retain backup (bank statements, receipts, and invoices) for all these transactions if you ever need to support your entries.

A Word About Self-Employment Tax (Schedule SE)

Though it doesn't appear here, this is always worth mentioning. If you are running a profit, don't lose sight of the fact that you will probably need to pay self-employment tax. If you

were working for someone else & getting W-2 reportable wages, you know that you would have a portion deducted for Social Security & Medicare taxes. And, your employer would also be paying these amounts. Now that you're in business for yourself, you are both employer & employee, and it is your responsibility to pay both portions. This tax is based upon the profitability of your business as reported on Schedule C & not on your taxable income as reported on Form 1040. Hence, it is not uncommon for someone to owe no "income tax" at the time that they file, but still owe substantial self-employment taxes (& penalties, if quarterly estimated payments have not been made).

Every year, I see people fall into this trap. Please don't be one of them. Talk to me about how your business is doing throughout the year, and I will set up your quarterly estimated payments if they are needed.