O'MALLEY & BERBERICH
CPAs P.C.

SETTING UP YOUR RECORDS

When starting a business you should set up a system of recordkeeping that is suitable for your business. You should keep in mind the taxes you will have to pay and when you will have to pay them.

CHOOSING AN ACCOUNTING METHOD AND A TAX YEAR

You should set up your books using an accounting method that clearly shows you income for the accounting period that is your tax year.

CHOOSING A 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 good for everyone. You may find the double-entry system is better because it has built-in checks and balances to assure accuracy and control.

Single-entry bookkeeping is a system that is based on the income statement and not on the balance sheet. It can be a simple and very practical if you are starting out in a small business. For tax purposes the system records the flow of income and expenses through the use of a daily summary of cash receipts, a monthly summary of receipts, and a monthly summary of disbursements.

Double-entry bookkeeping uses journals and ledgers. Transactions are first entered in a journal and then summary totals of the transactions (usually monthly) are entered in ledger accounts. Ledger accounts are of five types: income, expense, asset. Liability, and net worth. Income and expense accounts are closed at the end of the annual accounting period. Asset, liability, and net worth accounts are kept on a permanent basis.

The double-entry system is self-balancing. Every journal entry is made up of both debits and credits. The sum of the debits must equal the sum of the credits in each journal entry. Thus, after the journal entries are entered in the ledger accounts, the debits total equals the credits total, and the accounts are in balance.

At the end of each accounting period, financial statements may be prepared. These statements are generally the income statement and the balance sheet. The income statement reflects the current operations for the year. The balance sheet shows the financial position of the business in terms of assets, liabilities, and net worth at an exact point in time.

RECORDKEEPING

You should deposit all business receipts in a separate bank account. You should also make all disbursements by check, if possible. In this way both business income and business expenses will be well documented.

You should write checks payable to yourself only when making withdrawals of income from your business for your own use. Avoid writing checks payable to cash. This will help you to know which disbursements are for business and which are for personal reasons.

RECORDKEEPING (CONTINUED)

You should establish a petty cash fund for small expenses. All business expenses paid by cash should be supported by documents showing their business purpose.

If you must write a check payable to cash or to yourself in order to get the 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, put a statement in your records at the time of payment to explain the payment.

SUPPORT YOUR ENTRIES

Canceled checks, paid bills, duplicate deposit slips, and other items that support entries in you books should be filed in an orderly manner and stored in a safe place. Memorandums or sketchy records that approximate income, deductions, or other items affecting your tax liability will not be considered adequate.

CLASSIFY YOUR ACCOUNTS

You should divide your accounts into five groups: income, expenses, assets, liabilities, and equity (net worth). Asset accounts should be further classified as current or fixed. For your assets, you should record in detail date of acquisition, cost or other original basis, depreciation, depletion, and anything else affecting their basis.

KEEP YOUR RECORDS

You must keep the books and records of your business available at all times for inspection by the Internal Revenue Service. The records must be kept as long as they may be needed in the administration of any Internal Revenue law.

RETAIN COPIES

Keep records supporting items on a tax return until the statute of limitations for that return runs out. Usually, the statute of limitations for an income tax return ends 3 years after the return is due or filed, or 2 years from the date the tax was paid, whichever occurs later. However, you should keep some records indefinitely.

Keep records that verify your basis in property for as long as they are needed to figure the basis of the original or replacement property. In addition, these records are needed for figuring investment credit.

Occasionally, Congress passes laws giving relief to taxpayers in certain situations. You will be able to take advantage of these laws only if your records show that you are eligible. Your records can prove that you had the needed transactions in earlier years.

Keep copies of your tax returns. They will help you in preparing your future tax returns, and in making computations if you later file a claim for refund. They may also be helpful to the executor of your estate or the Internal Revenue Service if your original return is not available.

EFFECTIVE RECORDS

Good records are needed for good management. The following list shows what good records can do for you.

IDENTIFY SOURCE OF RECEIPT

The money or property you receive can come from many sources. Your records can identify the source of your receipts. For example, so you can prove that they are from non-business sources, or that they are not taxable.

KEEP TRACK OF DEDUCTIBLE EXPENSES

Expenses may be forgotten when you prepare your tax return, unless you record them when they occur.

FIGURE DEPRECIATION ALLOWANCE

You should record the assets you can depreciate in a permanent record. Without a record of the cost and other information on your assets, you cannot figure your depreciation deductions. If the assets are sold or become fully depreciated, or if capital improvements are made to them, only a permanent record will show how much of their cost you have not recovered.

TAKE ADVANTAGE OF CAPITAL GAIN AND LOSS LAWS

If your records are good and complete, they will show the data an asset was acquired, what it was used for, and whether it was sold, traded, destroyed, or otherwise disposed of. With this information you may be able to use the capital gain or loss laws. You also may be allowed to put off paying tax on certain gains, or to deduct 100% of certain losses that otherwise would not be deductible or would be only partly deductible.

FIGURE YOUR EARNINGS FOR SELF-EMPLOYMENT TAX PURPOSES

The self-employment tax is part of the system for providing social security coverage for people who work for themselves. Your social security benefits when you retire, or are disabled, or that your family can get when you die, depend on how much you earn Your records should show how much of your earnings you pay self-employment tax on.

SUPPORT ITEMS REPORTED ON YOUR TAX RETURNS

If any of your tax returns are examined by the Internal Revenue Service, you may be asked to explain the items reported. A complete set of records will speed up the examination. Adequate and complete records are always supported by sales slips, invoices, receipts, bank deposit slips, canceled checks, and other documents.

RECORDS OF EMPLOYERS

You must keep all your records on employment taxes (income tax withholding, social security, and federal unemployment tax) for at least 4 years after the due date of the return of after the date the tax is paid, whichever is later. In addition to the following items required for each specific type of employment tax, your records should also contain your employer identification number, copies of the returns you have filed, and the dates and amounts of deposits you made.

INCOME TAX WITHHOLDING

The specific records you must keep for income tax withholding are:

1. Each employee’s name, address, and social security number.
2. The total amount and date of each wage payment and the period of time the payment covers.
3. For each wage payment, the amount subject to withholding.
4. The amount of withholding tax collected on each payment and the date it was collected.
5. If the taxable amount is less than the total payment, the reason why it is.
6. Copies of any statements furnished by employees relating to nonresident alien status, residence in Puerto Rico or the Virgin Islands, or residence or physical presence in a foreign country.
7. The fair market value and date of each payment of non-cash compensation made to a retail commission salesperson, if no income tax was withheld.
8. For wage continuation plans, information about the amount of each payment.
9. The withholding exemption certificates (Form W-4) filed by each employee.
10. Any agreement between you and the employee for the voluntary withholding of additional amounts of tax.
11. The dates in each calendar quarter on which the employees worked for you, but not in the course of your trade or business, and the amount paid for that work.
12. Copies of statements given you by employees reporting tips received in their work, unless the information shown on the statements appears in another item on the list.
13. Requests by employees to have the tax withheld figured on the basis of their individual cumulative wages.

An employees earnings ledger, which you can buy at most office supplies stores, normally has space for the information required in items (1) to (4).

SOCIAL SECURITY TAXES

You must maintain the following information in your records on the social security (FICA) taxes of your employees:

1. The amount of each wage payment subject to FICA tax.
2. The amount of FICA tax collected for each payment and the date collected.
3. If the total wage payment and the taxable amount differ, the reason why they do.

FEDERAL UNEMPLOYMENT TAX ACT

Additional information in your records required by the Federal Unemployment Tax Act (FUTA) is:

1. The total amount paid to your employees during the calendar year.
2. The amount of compensation subject to the unemployment tax.
3. The amount you paid into the state unemployment fund.
4. Any other information required to be shown on the unemployment tax return, and the amount of the tax.