

# Your First Business Tax Return

## A checklist for first time filers of business tax returns

- **Review the Form Completely**

First, take a look at a copy of the [business tax return](#) you will file to see which line items on the return you'll be expected to fill in with amounts.

Also, if there are questions asked on the return, make sure you have the answers to those questions. These could include the nature of the business, is it your first year in business, and your business location.

Make sure your chart of accounts has the correct categories of income and expenses for you to both manage your business and properly file your returns. While all businesses must keep complete and accurate records, many do not reach that mandate without an effort to ensure they are in compliance with the law.

- **Accounting Basis**

One decision the owner must make is whether to prepare the tax returns on the [cash or accrual basis](#). Under the cash basis, income is recognized when collected and expenses are recognized when paid. Under the accrual basis, income is recognized when earned and expenses are recognized when incurred. While lenders will generally prefer to see accrual basis financial statements, tax returns can still be prepared on the cash basis even if the financial statements are prepared on the accrual basis.

A new business might have more unpaid expenses than uncollected income at year-end, and therefore might consider taking those additional net expenses as a deduction. This would be done by selecting the accrual basis. However, in later years when the business is profitable, receivables should be greater than payables, and so the business would be recording additional net income and paying more taxes if it had selected the accrual basis instead of the cash basis.

Once you make the decision on which basis to use you will stay with it throughout the life of your business, although changes are permitted. Certain businesses, including those with larger revenues or inventories, must choose the accrual basis.

- **Depreciation Method**

The next decision to consider is which [depreciation method](#) to use. The Internal Revenue Service permits a first-year deduction of up to \$100,000 for most furniture and equipment, instead of writing off the cost over five or seven years. So, most business owners would generally elect to take the first year write off.

However, businesses without profits can't deduct the first year depreciation deduction, although they can carry it forward to profitable years. A business in its early stages might consider taking the slower depreciation route so that most of the deductions will be available when the business has income and is in a higher tax bracket than in the startup phase.

- **Home Office Deduction**

Sole proprietors in home-based business locations should consider the ability to deduct a portion of their residence as a business deduction. To be successful in this widely contested area, the business area used in the home must be used exclusively for business.

The business owner would measure both the square footage of the home used for business and the total square footage of the home. The resulting percentage of business use would be applied to [home office expenses](#) to determine the amount to be deducted. If the business has a loss, then a home-based business deduction is not allowed but can be carried forward.

In order to properly account for the business use of the home, the business owner would first deduct the percentage of the real estate taxes and mortgage interest that would otherwise be taken as an itemized deduction. If there are still profits remaining, then other home expenses such as landscaping, and general home repairs would be allocated to the business and personal portion, and a deduction would be allowed for the business portion.

Finally, if there is still a profit, then depreciation on the home is allowed on the business portion.

To calculate depreciation, the cost of the home must be allocated between the cost of the land (which is not deductible) and the building. The building must then be allocated between the business and personal portions by the percentage calculated earlier. The resulting depreciation deduction is then written off over almost a forty year period, and the actual annual home depreciation expense would usually not be more than a few hundred dollars.

- **Non-employee Compensation**

Another piece to year-end tax returns is the review of independent contractors you paid to see if the government must be notified of their non-employee compensation. Your employees receive a W-2 form to identify their income and withholding tax. Similarly, your contractors who make \$600 (as of 2021 tax year) or more would receive form [1099-MISC](#) from you, and the federal and state governments would also receive a copy.

Contractors who are corporations are exempt from receiving this form, but partnerships and limited liability companies with more than one member must receive them. If you wait until year-end to obtain the contractor's social security number or

employer identification number you might not be successful in obtaining that required information. Have your [contractors fill out form W-9](#) to give you the needed information.

- **Automobile Expenses**

Automobile expense can be a major expense for a new or existing business. The business owner should maintain an auto log to keep track of where and when he or she traveled to, who was seen, and if there was a business purpose to the trip. While some individuals only track business use, I recommend keeping the log for all auto expenses, since those who itemize their deductions can also deduct transportation as a medical expense, and as a charitable contribution deduction if active in a charity. The business tax returns will want to know when you placed the vehicle in service, and the amount of the business, commuting and personal miles for each vehicle for the year.

- **Self-Employment Tax**

Profitable sole proprietors are sometimes surprised to find that self-employment tax ( social security and medicare tax for self-employed individuals) can be overlooked and may be a significant part of their total tax bill. Be sure to calculate these taxes as part of your total estimated taxes when paying quarterly estimates. Also, be prepared for the April 15 surprise. Not only is the balance due for last year's taxes, but also due is the first quarter installment of the next year's taxes. Cash flow must be monitored to have these funds available.

## **WHICH BUSINESS EXPENSES CAN I DEDUCT FROM MY TAXES?**

- Home-office
- Rent
- Phones
- Utilities
- Postage
- Health insurance
- Auto expenses
- Internet access
- Business travel
- Business meals and entertainment
- Professional services and consultants
- Business cards and stationery
- Retirement plans
- Interest payments on business credit cards
- Education
- Office supplies
- Office furniture
- Anticipated liabilities
- Bribes and kickbacks
- Demolition expenses
- Personal expenses
- Social or recreational clubs
- Lobbying expenses
- Political contributions
- Federal income taxes
- Penalties and fines as a result of breaking the law

## HOW TO SET UP A CHART OF ACCOUNTS FOR BOOKKEEPING

**The Chart of Accounts usually includes at least three columns:**

- Account: Lists the account names.
- Type: Lists the type of account — asset, liability, equity, income, cost of goods sold, or expense.
- Description: Contains a description of the type of transaction that should be recorded in the account.

Many companies also assign numbers to the accounts, to be used for coding charges. If your company is using a computerized system, the computer automatically assigns the account number. Otherwise, you need to plan out your own numbering system.

- **The most common number system is:**

Asset accounts: 1,000 to 1,999

Liability accounts: 2,000 to 2,999

Equity accounts: 3,000 to 3,999

Sales and Cost of Goods Sold accounts: 4,000 to 4,999

Expense accounts: 5,000 to 6,999

This numbering system matches the one used by computerized accounting systems, making it easy for a company to transition if at some future time it decides to automate its books using a computerized accounting system.

The sample Chart of Accounts, shown, was developed using QuickBooks. You can see a few accounts that are unique to the business, such as Cooking Supplies, and other accounts that are common only to retail business, such as Cash Discrepancies and Merchant Fees.

Name	Type	Description
+Checking	Bank	
+Petty Cash	Bank	
+Accounts Receivable	Accounts Receivable	
+Inventory Asset	Other Current Asset	
+Undeposited Funds	Other Current Asset	
+Equipment	Fixed Asset	
+Depreciation	Fixed Asset	
+Original Cost	Fixed Asset	
+Furniture	Fixed Asset	
+Depreciation	Fixed Asset	
+Original Cost	Fixed Asset	
+Vehicles	Fixed Asset	cars, trucks, etc
+Accounts Payable	Accounts Payable	
+Local Bank USA	Credit Card	
+Bank Credit Line Payable	Other Current Liability	bank credit line
+Credit Cards Payable	Other Current Liability	
+Payroll Liabilities	Other Current Liability	
+Sales Tax Payable	Other Current Liability	
+Car Payable	Long Term Liability	Car loans
+Equipment Purchase	Long Term Liability	
+Opening Bal Equity	Equity	
+Owner's Capital	Equity	Owner's Capital
+Draws	Equity	Draws
+Investments	Equity	Investments
+Retained Earnings	Equity	
+Cash Discrepancies	Income	Cash Discrepancies
+Overages	Income	Cash Overages
+Shortages	Income	Cash Shortages
+Sales	Income	Sales
+Consignment Sales	Income	Consignment Sales
+Discounts Given	Income	Sales Discounts Given
+Merchandise	Income	Sales - Merchandise
+Service	Income	Sales - Service
+Shipping and Handling	Income	Sales - Shipping and Handling
+Cooking Supplies	Cost of Goods Sold	
+Cost of Goods Sold	Cost of Goods Sold	
+Purchase Discounts	Cost of Goods Sold	Purchase Discounts
+Purchases	Cost of Goods Sold	Purchases
+Automobile Expense	Expense	Automobile Expense
+Bad Debt Expense	Expense	Bad Debts
+Bank Service Charges	Expense	Bank Service Charges
+Charitable Contributions	Expense	Contributions
+Depreciation Expense	Expense	Depreciation Expense
+Dues and Subscriptions	Expense	Dues and Subscriptions