



For Tuesday, January 11, please read pp. 1-13 of IRS Publication 583, Starting a Business & Recordkeeping & be prepared to answer these questions—

1. What's an example of a *payee identification number*?
2. Browne is a solo practitioner. Under what circumstances would Browne have to pay *estimated tax*?
3. What's the difference between Forms I-9, W-4, W-2 and 8300?
4. Very briefly explain the tax relevance of, and difference between, a *journal* and a *ledger*.
5. What are business *inventories*? Give an example.



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Starting a Business and Keeping Records

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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 recordkeeping system.

Throughout this publication we refer 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) at [SBA.gov](https://www.sba.gov).

Comments and suggestions. We welcome your comments about this publication and suggestions for future editions.

What New Business Owners Need To Know

As a new business owner, you need to know your federal tax responsibilities. [Table 1](#) can help you learn what those responsibilities are. Ask yourself each question listed in the table, then see the related discussion to 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 these types of questions. For information about the SBA, see [SBA.gov](https://www.sba.gov).

Determining Which Type of Business to Use

The most common forms of business are the sole proprietorship, partnership, and corporation. When beginning a business, you must decide which form of business to use.

Table 1. What New Business Owners Need To Know About Federal Taxes

(Note: This table is intended to help you, as a new business owner, learn what you need to know about your federal tax responsibilities. To use it, ask yourself each question in the left column, then see the related discussion in the right column.)

What must I know?	Where to find the answer...
Which form of business will I use?	See Determining Which Type of Business to Use .
Will I need an employer identification number (EIN)?	See Getting a Taxpayer Identification Number .
Do I have to start my tax year in January, or may I start it in any other month?	See Designating a Tax Year .
What method can I use to account for my income and expenses?	See Choosing an Accounting Method .
What kinds of federal taxes will I have to pay? How should I pay my taxes?	See Business Taxes .
What must I do if I have employees?	See Employment Taxes .
Which forms must I file?	See Table 2 and Information Returns .
Are there penalties if I do not pay my taxes or file my returns?	See Penalties .
What business expenses can I deduct on my federal income tax return?	See Deducting Business Expenses .
What records must I keep? How long must I keep them?	See Recordkeeping .

Legal and tax considerations enter into this decision. Only tax considerations are discussed in this Pub. .



Your form of business determines which income tax return form you have to file. See [Table 2](#) to find out which form you have to file.

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. You undertake the risks of the business for all assets owned, whether or not used in the business. You include the income and expenses of the business on your personal tax return.

More information. For more information on sole proprietorships, see Pub. 334, Tax Guide for Small Business (For Individuals Who Use Schedule C). If you are a farmer, see Pub. 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 must file an annual information return to report the income, deductions, gains, losses, etc., from its operations, but it does not pay income tax. Instead, it "passes through" any profits or losses to its partners. Each partner includes his or her share of the partnership's items on his or her tax return.

More information. For more information on partnerships, see Pub. 541, Partnerships.

Corporations. In forming a corporation, prospective shareholders exchange 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.

C corporations. The profit of a C corporation is taxed to the corporation when earned, and then is taxed to the shareholders when distributed as dividends. However, shareholders cannot deduct any loss of the corporation. For more information on corporations, see Pub. 542, Corporations.

S corporations. An eligible domestic corporation (or a domestic entity eligible to elect to be treated as a corporation) can avoid double taxation (once to the corporation and again to the shareholders) as long as it meets certain tests and elects to be treated as an S corporation. Generally, an S corporation is exempt from federal income tax other than tax on certain capital gains and passive income. On their tax returns, the S corporation's shareholders include their share of the corporation's separately stated items of income, deduction, loss, and credit, and their share of nonseparately stated income or loss. For more information on S corporations and the tests that need to be met to be eligible to elect to be an S corporation, see the instructions for Form 2553, Election by a Small Business Corporation, and Form 1120-S, U.S. Income Tax Return for an S Corporation.

Limited liability company. A limited liability company (LLC) is an entity formed under state law by filing articles of organization as an LLC. The members of an LLC are not personally liable for its debts. An LLC may be classified for federal income tax purposes as either a partnership, a corporation, or an entity disregarded as separate from its owner by applying the rules in Regulations section 301.7701-3.

More information. For more information on LLCs, see the Instructions for Form 8832, Entity Classification Election.

Getting a Taxpayer Identification Number

You must have a taxpayer identification number so the IRS can process your returns. Two of the most common

kinds of taxpayer identification numbers are the social security number (SSN) and the employer identification number (EIN).

- An SSN is issued to individuals by the Social Security Administration (SSA) and is in the following format: 000-00-0000.
- An EIN is issued to individuals (sole proprietors), partnerships, corporations, and other entities by the IRS and is in the following format: 00-0000000.

Providing your identification number to others. You must include your taxpayer identification number (SSN or EIN) on all returns and other documents you send to the IRS. You must also give 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 filed to report the following information.

1. Interest, dividends, royalties, etc., paid to you.
2. Any amount paid to you as a dependent care provider.
3. Certain other amounts paid to you that total \$600 or more for the year.

If you do not furnish your identification number as required, you may be subject to penalties. See [Penalties](#), later.

Employer Identification Number (EIN)

EINs are assigned to sole proprietors, LLCs, corporations, and partnerships for tax filing and reporting purposes. See Form SS-4 and its instructions for more information and to see which businesses must get an EIN.

Applying for an EIN. You may apply for an EIN:

- Online—Click on the Employer ID Numbers (EINs) link at [IRS.gov/businesses/small](https://www.irs.gov/businesses/small). The EIN is issued immediately once the application information is validated.
- By mailing or faxing Form SS-4, Application for Employer Identification Number.
- International applicants may call 267-941-1099 (not a toll-free number).

More than one EIN. You should have only one EIN for a business entity. If you have more than one EIN and are

not sure which to use, contact the Internal Revenue Service Center where you file your return. Give the numbers you have, the name and address to which each was assigned, and the address of your main place of business. The IRS will tell you which number to use.

More information. For more information about EINs, see Pub. 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](#)). The forms used to report these payments must include the payee's identification number.

Employee. If you have employees, you must get an SSN from each of them. Record the name and SSN 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, the employee should request a new card from the SSA. This may occur, for example, if the employee's name has changed due to marriage or divorce.

If your employee does not have an SSN, he or she should file Form SS-5, Application for a Social Security Card, with the SSA. This form is available at SSA offices or by calling 800-772-1213. It is also available from the SSA website at [SSA.gov](https://www.ssa.gov).

Other payee. If you make payments to someone who is not your employee and you must report the payments on an information return, get that person's SSN. If you make reportable 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. For more information, see [IRS.gov/FormW9](https://www.irs.gov/FormW9).

If the payee does not provide you with an identification number, you may have to withhold part of the payments as backup withholding. For information on backup withholding, see the Instructions for the Requester of Form W-9 and the General Instructions for Certain Information Returns.

Designating a 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.

1. **Calendar tax year.** A calendar tax year is 12 consecutive months beginning January 1 and ending December 31.
2. **Fiscal tax year.** A fiscal tax year is 12 consecutive months ending on the last day of any month except December. A 52-53-week tax year is a fiscal tax year

that varies from 52 to 53 weeks but does not have to end on the last day of a month.

If you file your first tax return using the calendar tax year and you later begin business as a sole proprietor, become a partner in a partnership, or become a shareholder in an S corporation, you must continue to use the calendar year unless you get IRS approval to change it or are otherwise allowed to change it without IRS approval.

You must use a calendar tax year if:

- You keep no books or records.
- You have no annual accounting period.
- Your present tax year does not qualify as a fiscal year.
- You are required to use a calendar year by a provision of the Internal Revenue Code or the Income Tax Regulations.

For more information, see Pub. 538, Accounting Periods and Methods.

First-time filer. If you have never filed an income tax return for your business, you can adopt either a calendar tax year or a fiscal tax year. Although, some partnerships and S corporations must use a particular tax year. See Pub. 538 for more information.

You adopt a tax year by filing your first income tax return using that tax year. You have not adopted a tax year if all you did was one or more of the following.

- Filed an application for an extension of time to file an income tax return.
- Filed an application for an employer identification number.
- Paid estimated taxes for that tax year.

Choosing an Accounting Method

An accounting method is a set of rules used to determine when and how income and expenses are reported. You choose an accounting method for your business when you file your first income tax return. There are two basic accounting methods.

1. **Cash method.** Under the cash method, you report income in the tax year you receive it. You usually deduct or capitalize expenses in the tax year you pay them.
2. **Accrual method.** Under an accrual method, you generally report income in the tax year you earn it, even though you may receive payment in a later year. You deduct or capitalize expenses in the tax year you incur them, whether or not you pay them that year.

For other methods, see Pub. 538.

If an inventory is necessary to account for your income, 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. Inventories are explained in Pub. 538.



Certain small business taxpayers can use the cash method of accounting and can also account for inventorable items as materials and supplies that are not incidental. For more information, see Pub. 538.

You must use the same accounting method to figure your taxable income and to keep your books. Also, you must use an accounting method that 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.

Business Taxes

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

- Income tax.
- Self-employment tax.
- Employment taxes.
- Excise taxes.

See [Table 2](#) for the forms you file to report these taxes.



You may want to get Pub. 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.

Table 2. Which Forms Must I File?

IF you are a...	THEN you may have to pay...	FILE form...
Sole proprietor	Income tax	1040 or 1040-SR, and Schedule C ¹ (Schedule F ¹ for farm business)
	Self-employment tax	1040 or 1040-SR, and Schedule SE
	Estimated tax	1040-ES
	Employment taxes: • Social security and Medicare taxes and income tax withholding • Federal unemployment (FUTA) tax	941 or 944 (943 for farm employees) 940
	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 or 1040-SR, and Schedule E ²
	Self-employment tax	1040 or 1040-SR, and Schedule SE
	Estimated tax	1040-ES
C corporation or S corporation	Income tax	1120 (C corporation) ² 1120-S (S corporation) ²
	Estimated tax	1120-W (corporation only)
	Employment taxes	Same as sole proprietor
	Excise taxes	See Excise Taxes
S corporation shareholder	Income tax	1040 or 1040-SR, and Schedule E ²
	Estimated tax	1040-ES

¹ File a separate schedule for each business.

² Various other schedules may be needed.

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. If you are not required to make estimated tax payments, you may pay any tax due when you file your return.

Reminder. If your business is an LLC, how you elected to have the LLC treated for tax purposes (either as a corporation, partnership, or as part of the LLC owner's tax return) will determine what taxes you must pay and what forms you should use to pay your taxes.

Estimated tax. Generally, you must pay taxes on income, including self-employment tax (discussed next), by making regular payments of estimated tax during the year.

Sole proprietors, partners, and S corporation shareholders. You generally have to make estimated tax payments if you expect to owe tax of \$1,000 or more when you file your return. Use Form 1040-ES, Estimated Tax for Individuals, to figure and pay your estimated tax. For more information, see Pub. 505, Tax Withholding and Estimated Tax.

Corporations. You generally have to make estimated tax payments for your corporation if you expect it to owe tax of \$500 or more when you file its return. Use Form 1120-W, Estimated Tax for Corporations, to figure the estimated tax. You must deposit the payments as explained later under [Depositing Taxes](#). For more information, see Pub. 542.

Self-Employment Tax

Self-employment tax (SE tax) is a social security and Medicare tax primarily for individuals who work for themselves. Your payments of SE tax contribute to your coverage under the social security system. Social security

coverage provides you with retirement benefits, disability benefits, survivor benefits, and hospital insurance (Medicare) benefits.

You must pay SE tax and file Schedule SE (Form 1040) if either of the following applies.

1. Your net earnings from self-employment were \$400 or more.
2. You had church employee income of \$108.28 or more.

Use Schedule SE (Form 1040) to figure your SE tax. For more information, see Pub. 334.



You can deduct a portion of your SE tax as an adjustment to income on your Form 1040 or 1040-SR.

The Social Security Administration (SSA) time limit for posting self-employment income. Generally, the SSA will give you credit only for self-employment income reported on a tax return filed within 3 years, 3 months, and 15 days after the tax year you earned the income. If you file your tax return or report a change in your self-employment income after this time limit, the SSA may change its records, but only to remove or reduce the amount. The SSA will not change its records to increase your self-employment income.

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.

Employment taxes include the following.

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

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

If you are not sure whether the people working for you are your employees, see Pub. 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. Also, people who provide a service generally associated with the sharing (or on-demand, gig, or access) economy are, under certain circumstances, independent contractors. An independent contractor is someone who is self-employed. Generally, you do not have to withhold or pay any taxes on payments to an independent contractor. If you wrongly classify an employee as an independent contractor, you can be held liable for employment taxes for that worker plus a penalty.

Federal Income, Social Security, and Medicare Taxes

You generally must 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 under [Hiring Employees](#)) and the methods described in Publication 15-T, Federal Income Tax Withholding Methods. Pub. 15-T provides instructions about how to apply Form W-4 to calculate withholding on the employee.

Social security and Medicare taxes pay for benefits that 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 of FICA. You withhold part of these taxes from your employee's wages and you pay a part yourself. To find out how much social security and Medicare tax to withhold and to pay, see Pub. 15.

Which form do I file? Report these taxes on Form 941, Employer's QUARTERLY Federal Tax Return, or Form 944, Employer's ANNUAL Federal Tax Return. (Farm employers use Form 943, Employer's Annual Federal Tax Return for Agricultural Employees.)

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.

Which form do I file? Report federal unemployment tax on Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return. See Pub. 15 to find out if you can use this form.

Hiring Employees

Have the employees you hire fill out Form I-9 and Form W-4.

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 U.S. Citizenship and Immigration Services (USCIS) Form I-9, Employment Eligibility Verification. You can get the form from USCIS offices or from the USCIS website at [USCIS.gov](https://uscis.gov). Call the USCIS at 800-375-5283 for more information about your responsibilities.

Form W-4. Each employee must fill out Form W-4, Employee's Withholding Certificate. You will use the information provided on this form to figure the amount of income

tax to withhold from your employee's wages. For more information, see Pub. 15-T.

Form W-2 Wage Reporting

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 describes the excise taxes you may have to pay and the forms you have to file if you do any of the following.

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

For more information on excise taxes, see Pub. 510, Excise Taxes.

Depositing Taxes

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

You must use an electronic funds transfer (EFT) to make all federal tax deposits. Generally, an EFT is made using the Electronic Federal Tax Payment System (EFTPS). If you don't want to use EFTPS, you can arrange for your tax professional, financial institution, payroll service, or other trusted third party to make electronic deposits on your behalf.

Any business that has a federal tax obligation and requests a new EIN will automatically be enrolled in EFTPS. Through the mail, the business will receive an EFTPS PIN package that contains instructions for activating its EFTPS enrollment.

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 General Instructions for Certain Information Returns.

Form 1099-MISC. Use Form 1099-MISC, Miscellaneous Income, to report certain payments you make in your trade or business.

Form 1099-NEC. Use Form 1099-NEC, Nonemployee Compensation, to report certain payments you make in your trade or business. These payments include the following items.

- Payments of \$600 or more for services performed by someone who is not your employee.

- If you withheld certain federal income tax under the backup withholding rules regardless of the amount of the payment.

You may choose to report direct sales of \$5,000 or more of consumer goods to a person for resale on Form 1099-NEC rather than Form 1099-MISC. For more information on what to report on Form 1099-NEC, see the Instructions for Forms 1099-MISC and 1099-NEC.

Form W-2. You must file Form W-2, Wage and Tax Statement, to report payments to your employees, such as wages, tips, and other compensation, withheld income, social security, and Medicare taxes. For more information on what to report on Form W-2, see the Instructions for Forms W-2 and W-3.

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 in one transaction or two or more related business transactions. Cash includes U.S. and foreign coin and currency. It also includes certain monetary instruments such as cashier's and traveler's checks and money orders. For more information, see Pub. 1544, Reporting Cash Payments of Over \$10,000.

Penalties

The law provides penalties for not filing returns or paying taxes as required. Criminal penalties may be imposed for willful failure to file, tax evasion, or making a false statement.

Failure to file tax returns. If you do not file your tax return by the due date, you may have to pay a penalty. The penalty is based on the tax not paid by the due date. See your tax return instructions for more information about this penalty.

Failure to pay tax. If you do not pay your taxes by the due date, you will have to pay a penalty for each month, or part of a month, that your taxes are not paid. For more information, see your tax return instructions.

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 Pub. 15.

Failure to follow information reporting requirements. The following penalties apply if you are required to file information returns. For more information, see the General Instructions for Certain Information Returns.

- **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.

- **Failure to furnish correct payee statements.** A penalty applies if you do not furnish a required statement to a payee by the due date, if you do not include all required information, or if you report incorrect information.

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 include all the required information, or for including incorrect information, on a de minimis number of information returns if you correct the errors by August 1 of the year the returns are due. (To be considered de minimis, the number of returns cannot exceed the greater of 10 or 1/2 of 1% of the total number of returns you are required to file for the year.) There is also no penalty, and no need for a corrected return to be filed, for incorrect dollar amounts where no single amount differs from the correct amount by more than \$100 (\$25 for tax withheld).

Failure to supply taxpayer identification number. If you do not include your taxpayer identification number (SSN or EIN) or the taxpayer identification number of another person where required on a return, statement, or other document, you may be subject to a penalty of \$50 for each failure. You may also be subject to the \$50 penalty if you do not give your taxpayer identification number to another person when it is required on a return, statement, or other document.

Deducting Business Expenses

You can deduct business expenses on your business or personal income tax return, depending on the form of your business. These are the current operating costs of running your business. 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. There are many other expenses that you may be able to deduct. See your form instructions and Pub. 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 costs for advertising, travel, surveys, and training. These costs are generally capital expenses.

You usually recover costs for a particular asset (such as machinery or office equipment) through depreciation (discussed next). However, you can elect to deduct up to

\$10,000 of business start-up costs and up to \$5,000 of organizational costs. The \$10,000 deduction for business start-up costs is reduced by the amount your total start-up costs exceed \$60,000. The \$5,000 deduction for organizational costs is reduced by the amount your total organizational costs exceed \$50,000. Any remaining costs must be amortized.

For more information about amortizing start-up and organizational costs, see chapter 7 in Pub. 535.

Depreciation

If property you acquire to use in your business has a useful life that extends substantially beyond the year it is placed in service, 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.

Business property you must depreciate includes the following items.

- Office furniture.
- Buildings.
- Machinery and equipment.

You can choose to deduct a limited amount of the cost of certain depreciable property in the year you place the property in service. This deduction is known as the “section 179 deduction.” For more information about depreciation and the section 179 deduction, see Pub. 946, *How To Depreciate Property*.

 **TIP** *Depreciation must be taken in the year it is allowable. Allowable depreciation not taken in a prior year cannot be taken in the current year. If you do not deduct the correct depreciation, you may be able to make a correction by filing Form 1040-X, Amended U.S. Individual Income Tax Return, or by changing your accounting method. For more information on how to correct depreciation deductions, see chapter 1, How Do You Correct Depreciation Deductions?, in Pub. 946.*

Business Use of Your Home

To deduct expenses related to the business use of your home, you must meet specific requirements. However, even if you meet the requirements your deduction may still be limited.

To qualify to claim expenses for business use of your home, you must meet both the following tests.

1. Your use of the business part of your home must be:
 - a. Exclusive (however, see [Exceptions to exclusive use](#), later),
 - b. Regular,
 - c. For your trade or business, AND
2. The business part of your home must be one of the following:

- a. Your principal place of business (defined later),
- b. A place where you meet or deal with patients, clients, or customers in the normal course of your trade or business, or
- c. A separate structure (not attached to your home) you use in connection with your trade or business.

Exclusive use. To qualify under the exclusive use test, you must use a specific area of your home only for your trade or business. The area used for business can be a room or other separately identifiable space. The space does not need to be marked off by a permanent partition.

You do not meet the requirements of the exclusive use test if you use the area in question both for business and for personal purposes.

Exceptions to exclusive use. You do not have to meet the exclusive use test if either of the following applies.

1. You use part of your home for the storage of inventory or product samples.
2. You use part of your home as a daycare facility.

For an explanation of these exceptions, see Pub. 587, *Business Use of Your Home (Including Use by Daycare Providers)*.

Principal place of business. Your home office will qualify as your principal place of business for deducting expenses for its use if you meet the following requirements.

- You use it exclusively and regularly for administrative or management activities of your trade or business.
- You have no other fixed location where you conduct substantial administrative or management activities of your trade or business.

Alternatively, if you use your home exclusively and regularly for your business, but your home office does not qualify as your principal place of business based on the previous rules, you determine your principal place of business based on the following factors.

- The relative importance of the activities performed at each location.
- If the relative importance factor does not determine your principal place of business, the time spent at each location.

If, after considering your business locations, your home cannot be identified as your principal place of business, you cannot deduct home office expenses. However, for other ways to qualify to deduct home office expenses, see Pub. 587.

Simplified method. The simplified method is an alternative to the calculation, allocation, and substantiation of actual expenses normally required to determine your home office expense deduction. With this method, you will generally figure your deduction by multiplying \$5, the prescribed rate, by the area of your home (measured in square feet) used for a qualified business. The area you use to figure your deduction is limited to 300 square feet. For

more information about the simplified method, see Revenue Procedure 2013-13, 2013-06 I.R.B. 478, available at [IRS.gov/irb/2013-06_IRB#RP-2013-13](https://www.irs.gov/irb/2013-06_IRB#RP-2013-13).

Which form do I file? If you file Schedule C (Form 1040), use Form 8829, Expenses for Business Use of Your Home. However, if you elect to use the simplified method, use the Simplified Method Worksheet in the Instructions for Schedule C or Pub. 587.

If you file Schedule F (Form 1040) or are a partner, you should use the Worksheet To Figure the Deduction for Business Use of Your Home in Pub. 587. However, if you elect to use the simplified method, use the Simplified Method Worksheet in Pub. 587.

More information. For more information about business use of your home, see Pub. 587.

Car and Truck Expenses

If you use your car or truck in your business, you can deduct the costs of operating and maintaining it. 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 payments	Registration
Garage rent	Licenses	Repairs
Gas	Oil	Tires
Insurance	Parking fees	Tolls

If you use your vehicle for both business and personal purposes, you must divide your expenses between business and personal use. You can divide your expenses based on the miles driven for each purpose.

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

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 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 returns. 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 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 specific kind of records. You can choose any recordkeeping system suited to your business that clearly shows your income and expenses.

The business you are in affects the type of records you need to keep for federal tax purposes. You should set up your recordkeeping system using an accounting method that clearly shows your income for your tax year. See [Choosing an Accounting Method](#), earlier. If you are in more than one business, you should keep a complete and separate set of records for each business. A corporation should keep minutes of board of directors' meetings.

Your recordkeeping system should include a summary of your business transactions. This summary is ordinarily made in your 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 (discussed later) is the main source for entries in the business books. In addition, you must keep supporting documents, explained later.

Electronic records. All requirements that apply to hard copy books and records also apply to electronic storage systems that maintain tax books and records. When you replace hard copy books and records, you must maintain the electronic storage systems for as long as they are material to the administration of tax law. An electronic storage system is any system for preparing or keeping your records either by electronic imaging or by transfer to an electronic storage media. The electronic storage system must index, store, preserve, retrieve, and reproduce the electronically stored books and records in legible format. All electronic storage systems must provide a complete and accurate record of your data that is accessible to the IRS. Electronic storage systems are also subject to the same controls and retention guidelines as those imposed on your original hard copy books and records.

The original hard copy books and records may be destroyed provided that the electronic storage system has been tested to establish that the hard copy books and records are being reproduced in compliance with IRS requirements for an electronic storage system and procedures are established to ensure continued compliance with all applicable rules and regulations. You still have the responsibility of retaining any other books and records that are required to be retained.

The IRS may test your electronic storage system, including the equipment used, indexing methodology, software and retrieval capabilities. This test is not considered an examination and the results must be shared with you. If your electronic storage system meets the requirements mentioned earlier, you will be in compliance. If not, you may be subject to penalties for non-compliance, unless

you continue to maintain your original hard copy books and records in a manner that allows you and the IRS to determine your correct tax.

For details on electronic storage system requirements, see Revenue Procedure 97-22, available at [IRS.gov/Tax-Exempt-Bonds/Revenue-Procedures](https://www.irs.gov/Tax-Exempt-Bonds/Revenue-Procedures).

Supporting Documents

Purchases, sales, payroll, and other transactions you have in your business generate supporting documents. Supporting documents include sales slips, paid bills, invoices, receipts, deposit slips, and canceled checks. These documents contain 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. Keep them in an orderly fashion and in a safe place. For instance, organize them 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. Documents that show gross receipts include the following.

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

Inventory. Inventory is any item 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 inventory. Documents reporting the cost of inventory include the following.

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

These records will help you determine the value of your inventory at the end of the year. See Pub. 538 for information on methods for valuing inventory.

Expenses. Expenses are the costs you incur (other than the cost of inventory) 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.



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, and gift expenses. Specific recordkeeping rules apply to these expenses. For more information, see Pub. 463.

Employment taxes. There are specific employment tax records you must keep. For a list, see Pub. 15.

Assets. Assets are the property, such as machinery and furniture 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 the following information.

- 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 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.

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. These account statements must be highly legible. The following table lists acceptable account statements.

IF payment is by...	THEN the statement must show the...
Check	<ul style="list-style-type: none"> • Check number. • Amount. • Payee's name. • Date the check amount was posted to the account by the financial institution.
Electronic funds transfer	<ul style="list-style-type: none"> • Amount transferred. • Payee's name. • Date the transfer was posted to the account by the financial institution.
Credit card	<ul style="list-style-type: none"> • Amount charged. • Payee's name. • Transaction date.

Proof of payment of an amount, by itself, does not establish you are entitled to a tax deduction. You should also keep other documents, such as credit card sales slips and invoices, to show that you also incurred the cost.

Recording Business Transactions

A good recordkeeping system includes a summary of your business transactions. (Your business transactions are shown on the supporting documents just discussed.) Business transactions are ordinarily summarized in books called journals and ledgers. You can buy them over the Internet and 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 items.

- Business checkbook.
- Daily summary of cash receipts.
- Monthly summary of cash receipts.
- Check disbursements journal.
- Depreciation worksheet.
- Employee compensation record.