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ADJUSTMENTS FOR TAXES

At the end of the year, most small business owners, especially one-person companies, are perplexed by what kinds of deductions they can take and what types of adjustments they should make to their books.

ADJUSTMENTS TO THE BOOKS

Small business owners often miss these adjustments, which, unfortunately, affect their taxes.

- **Deposits/Retainers** – Did you receive a deposit or retainer for proposed work that you haven't delivered yet? If so, this is Unearned Revenue and should be moved to the Balance Sheet as a Liability "Unearned Revenues." If you don't, you **pay taxes** on income you haven't earned.
- **Accrued Employee Benefits** – Benefits that employees earn as they work, e.g., vacation leave, retirement benefits, bonuses, and profit sharing, should all be recognized as an expense in the year earned, not in the year paid. Earned benefits **MUST** be paid by law by the employer, therefore they are expenses of the company when the employee has earned them. If you don't, you understate your expenses and thus **pay more taxes**.
- **Prepaid Expenses** – Items like insurance, rent, bulk supplies, etc. and often paid annually or on a basis greater than a month. As such, any prepaid amount not yet used should be moved to the Balance Sheet as "Prepaid Assets." If you want your expenses to match the period they are used, this adjustment is necessary.
- **DEDUCTIBLE EXPENSES for TAXES**
- Before you create your tax return, whether it's a Schedule C, 1065, or 1120, make sure you have considered all deductible expenses recognized by the IRS.
- **Depreciation** - If you have capital assets, then a portion of that cost is deductible based on the type of item, its useful life, and its salvage value.
See the IRS MACRS tables.
- **Education for your job** – Did you take training to enhance your current job? Note: if the training leads to a degree that prepares you for another job, it is not deductible.
- **Healthcare costs** - If your company has a policy that states, "Employee (and family) healthcare costs are fully (or partially) covered by the company," then they are deductible. However, those costs must be fully documented and paid in accordance with the company policy. Do you have a 1095B?
- **Office in Home** – You will need the square footage of the area used for business purposes that you want to claim as your office in home. The IRS allows for a standard rate per square foot.
- **Vehicle expenses** - if you use your personal vehicle for company purposes, compute the total mileage for the year, personal mileage, and then business mileage. Only

business mileage is deductible at the IRS rate (\$0.70/mi), and any expenses paid by the company must be deducted from the calculated business cost. Remember, the IRS will want the date, from, to, mileage, and business reason for each such use.

- **Meals & Entertainment** - Entertainment is **not** deductible. Client Meals are only 50% deductible.

For meals, make sure you have them properly segregated into:

1. Client-related meals – 50% deductible; you need the names of the people who were there, the date, place, and reason for the meal.
2. Employee food – 100% if working late and couldn't get home for the meal, if there is food provided in a break room, or for training meals and group meeting meals.
3. Out-of-town – 100% for breakfast or dinner, but not lunch.

- **Personally-paid expenses incurred on behalf of the company** - These should be documented with substantiation on an Expense Report, and submitted to the company for reimbursement, e.g.,

- - - purchases made for the company but with personal funds
 - special clothing, tools, or gear required for work
 - phone, Internet, communications supplies
 - personal computer, installed software, and software subscriptions
 - personally-owned equipment used by the company, but not charged for
 - other vehicle expenses, parking

ADJUSTMENTS TO THE BOOKS TO MATCH YOUR TAX RETURN

Most small business owners just turn over their Trial Balance to a tax preparer, but never update their books to align with what's on their tax return.

- **Accumulated Depreciation** – When recording Depreciation Expense on the P & L, Accumulated Depreciation is the account that gets the other half of the transaction.
- **Non-deductible Client Meals** – 50% of these meals should be moved to Other Expenses (after Net Profit from Operations), with the other half of the transaction to an Equity account like “Book Changes to Match Tax Return.”
- **Home Office Expense** – The Home Office expense you deduct on your Tax Return should be put in “Home Office Expense” in Other Expenses (after Net Profit from Operations) with the other half of the transaction to an Equity account like “Book Changes to Match Tax Return.”
- **Reimbursed Employee Expenses (per Expense Reports)** – These should be entered just like any other expense, with the charge going to the appropriate expense account, **not** Reimbursed Expenses.

If you are a startup, small business, or nonprofit, MyAdvisor LLC is here to help you with bookkeeping, accounting, and tax services at value-priced rates.



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