

# SelfInformed

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*NASE Member  
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# PREPARING FOR TAXES

## *How to File an Audit-Proof Tax Return*

By Keith Hall

Most of us associate February with Valentine's Day flowers, Ground Hog's Day, or maybe even the birthday month of Abraham Lincoln. But for all of us who are also small business owners it is time to start thinking about that dreaded tax return. And worst of all is the thought that what if that tax return gets audited. It's a random Saturday morning and the weather is nice. You walk out to the mailbox with your fresh morning coffee almost skipping with a song in your step. Life is good. But then a big white envelope appears with the return address reading...Internal Revenue Service. Suddenly, the Saturday is not so bright and the coffee is not so fresh.

The IRS will examine approximately 1,500,000 tax returns out of approximately 150,000,000 that will be filed this year. That basically means that the chances of your tax return being selected for review are about one percent or one out of one hundred. If you file a Schedule C, Profit or Loss from Business meaning you are a sole proprietor your chances double to about two percent...and if you report over \$100,000 in gross

revenue on that Schedule C, your chances double again to about four percent. This may seem unfair at first, but keep in mind that your return has more forms, more complexities, more calculation and therefore more potential mistakes. The IRS certainly has endless amounts of detail about how taxpayers make mistakes on their tax returns and the examination process is designed to find those mistakes and correct them. Since we as small business owners have more chances to make mistakes we also have more chances of getting that ugly envelope on Saturday morning.

There isn't much we can do about the statistics of the audit process or about our chances of being included in that process but we can definitely take steps to make that process much less stressful. The best answer to reducing that stress is to find a way to prepare an audit proof tax return. And the time is now! Follow the five steps below as you approach the filing of your tax return this year and you will have an audit proof tax return.



1. Plan Your Attack
2. Get The Paper
3. Report All Income
4. Build Separate Support For Each Deduction
5. Avoid Short Cuts

Before we get to the specifics of each step, I want to give you a head start on your first audit by giving you the first question that you will be asked. The first question is always the same for ALL small business owners so once you read the next few sentences; you will always have correct answer to that first question. May I see your business bank statements? That's it. That will be your first question. If you can answer that question with a cordial, "Yes, you may," and then produce those monthly, neat, reconciled business bank statements a vast majority of all questions in the mind of the auditor will be answered. This is very important. If you haven't opened a separate bank account for your business, as soon as you finish reading this article, go down to your bank and open that account. And from today forward, never mix business and personal within the same bank account. This may very well be the most important factor in preparing audit proof tax returns.



## 1. PLAN YOUR ATTACK

Before you do one calculation or make one copy or take one single Advil, stop and think about how you are going to attack this year's tax return. There are basically two distinct paths for you to take. You can prepare the tax return yourself or you can hire a professional to do the tax return for you. Neither option is always best but it is a great idea to decide this first. Don't allow yourself to go through the angst of paper and software and headaches only to end up hiring someone on April 15<sup>th</sup> to save the day. It is my concerted opinion that most small business owners are fully capable of preparing their own return. This is especially true with today's technology and the help of software packages such as TurboTax, TaxAct, and even H&RBlock Tax Software. If you expect a particularly complicated year, maybe your first year as a small business owner, or maybe you have some accelerated depreciation options because you acquire a large amount of equipment this year, then this year might be a good year to consider using a professional. If on the other hand, this year is basically the same as last year, you might choose this year to do it yourself. The key point is to decide now which way to go. You might be about to save \$300 to \$500 or more by doing the return yourself but make sure to consider the time you will spend and make the best decision for your situation, but make that decision first.



## 2. GET THE PAPER

The reports that you have probably heard about the world moving toward a paperless society have not yet reached the Internal Revenue Service. The preparation and the support of your tax return are still largely based on a stack of paper. You most likely have already received a W-2 from your job, 1099s for your business, 1098s, 1099INTs, 5498s, brokerage statements, church giving statements, and on and on and on. Each of those pieces of paper will provide a needed number for the return but also the undisputed support for that return if the IRS comes calling with questions. Use last year's tax return as a "To-do" list. If you had a deduction or income item last year, you most likely will have that same number again, and now is the time to acquire its supporting piece of paper. As non-technology friendly as it sounds, each number on your tax return should have a piece of paper that supports that number. Don't wait for the IRS to ask for the support since most likely they won't ask for that piece of paper for several years. Now is the time to get the paper so make sure you build you own personal little paper fort and you will be glad you did.

## 3. REPORT ALL INCOME

The classic textbook tax advice is to always include all income on your return and then do everything you can, via deductions and credits to get that income back off of the return. The key for this step is to make sure you include ALL income. Don't forget to include all business income and not just the income reported to your on Forms 1099. All income that you generate in the course of your business activity will be taxable income and should be included. Don't forget to include any and all cash payments you received as well as any income in the form of exchange of services. If you provide your business services to repair my car in exchange for me preparing your tax return we both have taxable income to the extent of the value we received. Always remember that intestinally excluding income from your tax return is the "F" word for the IRS, and that is Fraud. Never, ever, exclude income. Certainly be aggressive on the deduction side and make sure you use all available benefits, but never exclude income.



## 4. BUILD SEPARATE SUPPORT FOR EACH DEDUCTION

This step could very well be an entire book and actually is the basis for many books and certainly the most important step in preparing your audit proof tax return. A vast majority of all questions that you are likely to get from the IRS will concern the deductions that you include on your return. Make sure that every number you include as a deduction has its own little stack of paper in support. While you are calculating, summarizing, estimating, or just making copies for your tax preparer take the time to “prove” your number. Easy examples include actual purchases such as office supplies, computer equipment, office rent, etc. These items can be supported by actual receipts, entries on your credit card statement or bank statement. Make some copies. Use your highlighter. Check the math. This may seem totally cumbersome but regardless of whether you use automated accounting software such as QuickBooks or Peachtree take the time to support each of your numbers. The paper exists al take the time to make the copies and build a separate support stack for each number.

Try and visualize a new game show called *Prove It*. Maybe Steve Harvey is the host and he calls you from the audience and says, “Your tax return shows \$3,415 in advertising expense...” he pauses for drama and points at you and says, “Prove It!” If you can prove the expense with some type of third party support you win \$10,000. Ask yourself what you would like to be able to show him. If you can answer that for each number on your tax return, you truly will have an audit proof tax return. When you have completed this task you will already have the answer to any question that could be asked. Don’t forget that the audit doesn’t happen on April 16th right after your file your return on April 15<sup>th</sup>. Instead, the audit is two and one half years later. You won’t remember why you chose 9,000 business miles for your car and maybe you won’t even have the same laptop that you bought and deducted this year. So NOW is the time to support your numbers. Build your support. Make the copies. Take the time to Prove It now and if you get that letter two years from now, you will be so glad you did.

## 5. AVOID SHORTCUTS

As you build the support for your audit proof tax return you will be tempted to take short cuts. You will be tempted to say things like, “Well, I have \$1,200 in cell phone bills last year, let’s just use that same number again.” Avoid those temptations and avoid those shortcuts. Take the time to download your cell phone bills. Make the copies. Add them up. It’s easy to do and the information is readily available. Unlike two and one half years from now when you may not be able to find the right detail. Invest the time. Avoid shortcuts.

If you can follow these five easy steps you will have an audit proof tax return. The cost is your time and the commitment to get all of the test questions correct. You have the detail, you have the ability, and it only takes that commitment. And you will never have to worry about that big white envelope ruining your Saturday morning coffee.





# Ask the Expert

**Q:** *I have been in business for about four years and things are going really well. Should I convert my business to an LLC or to a corporation to reduce how much I have to pay in taxes?*

**A:** Congratulations on your success and keep up the good work. Don't forget that over 70% of all new jobs in this country come from small business owners just like you, so well done. As your business continues to grow there may very well be good reasons to consider different entity forms but a material reduction in taxes is not one of them. At the end of the day the entity form under which you choose to operate will not have a significant impact on your overall income tax liability. Only the underlying economics of your business will dictate your tax liability and not simply choosing a different entity form.

There are certainly pros and cons to each entity form but this should not be a tax decision. Many small

businesses choose to operate as an LLC or as a corporation in order to provide some liability protection for their personal assets from potential liabilities of the business. Many choose a different entity form based on the need for raising capital or attracting public investment, and some also choose an entity form based on marketing or the perceived need for a "bigger" name using "incorporated" or "Inc." But again, other than the increased organization fees and maintenance costs the entity forms will not provide any material tax deductions or tax savings.

Be particularly cautious of entity form specialists who may 'guarantee' some level of tax savings solely for converting to a different entity form. If the underlying economics of your



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business have not changed, then changing entity forms with the sole goal of reducing your tax liability is not a good idea.



As always, don't forget that you are not alone. Bookmark our website at **NASE.org** as well as the IRS website at **IRS.gov** you will always be able to find the help you need.



# Member Benefits

Visit [www.NASE.org](http://www.NASE.org) to learn more about the following benefits!

New!

## Office DEPOT® OfficeMax®

NASE has partnered with Office Depot® to bring members a national discount program.

Office Depot and OfficeMax are now ONE company! NASE Members can save up to 80% on over 93,000 products. Great for your printing, hardware, software and all of your office supply needs. Shop online or in any Office Depot or OfficeMax store. Enjoy FREE next-day delivery when online orders over \$50 are placed.

### NASE Program Benefits Include:

- Up to 80% off preferred products
- 93,000 products discounted below retail price
- FREE next-day delivery on online orders over \$50 (excludes furniture)
- Conveniently shop online or visit one of our local stores
- Exclusive low printing costs
- 100% satisfaction guaranteed



**SaveAround® Welcomes NASE Members!** As part of the NASE's preferred membership with SaveAround®, members will receive an annual digital membership with the purchase of any SaveAround® Coupon Book.

### **Benefits:**

- Receive extremely rich discounts from local businesses in their hometowns in a simple turnkey product.
- Access to mobile and digital offers for even more savings nationwide.
- Opportunity to save even more with SaveAround's national partners across the US.
- Provide these great discounts as a gift for your employees, customers, or for your own family.
- Use as a great marketing tool for your small business to attract customers.



# Member Benefits

Visit [www.NASE.org](http://www.NASE.org) to learn more about the following benefits!

New!



NASE has partnered with Connect Lending who provides an online platform to match business owners to the right lender for their business solution. Read the [Press Release](#) here.

#### Free Access Platform:

- No upfront or hidden fees to access our platform
- Credit inquiries done after you decide on a lender

#### Lenders Compete for Your Business:

- Compare multiple loan options in order to make an informed borrowing decision
- Review lenders that match your current credit, collateral and funding timelines

#### User Friendly:

- Access our easy-to-use software from any web browser on any device
- Receive instant notifications and status updates

#### Knowledgeable Support:

- Receive professional assistance from our advisors through the entire loan process

Login today and discover how easy it is to find your lender... [Get Started](#)



## Hire Your Kid and reduce your taxable income by \$6,000

### Why should you Hire Your Kid?

Creating a job for your child can be a rewarding experience for both you and the child. A job can promote maturity, understanding, a sense of pride and self-worth. However, creating this new job will do one thing for sure, and that is save you thousands of dollars in taxes.

That's why we are here! Your first thought to the Hire Your Kid Tool Kit most likely is that it is too good to be true. Create a job, do the paperwork, file the tax returns, report the wages, and you will pay thousands less in taxes on April 15th. The best news is that we will do all the work. You pay the kid and we will do the rest.



## Member Spotlight



# Caring Self-Employment

*Ernesto Dominguez is the owner of **The Senior Club Professional Advanced Day Care** located in Miami, Florida. The Senior Club provides services for the elderly so they have a safe, supportive, cheerful environment where they participate in various care programs and have positive social interaction. Despite two previous senior care facilities failing at the same location, Ernesto and his wife Lizbet opened their business in 2012 and haven't looked back. Knowing how difficult it was going to be starting a business, Ernesto joined the NASE and quickly put to use the benefits provided. As the business became successful, they applied for and received an NASE Growth Grant so they could expand their business and serve more customers.*

*" I began seeing how important it was to properly take care of elderly people ...  
I knew I could be more successful and provide better care."*

**What inspired you to enter the field you are in?**

As someone who has been in the medical field my whole life, I knew how important it was for aging seniors with diseases and disabilities to have a place for positive experiences. Not only did I want to start a business where we could care for those in need but we wanted to ensure that we were a powerful instrument for the families taking care of our participants. I am continually inspired by seeing the improvement in the quality of life in our participants and the gratefulness from their families.

**When and why did you start your business?**

As I was working as a Registered Nurse, I began seeing how important it was to properly take care of elderly people, especially those suffering with diseases like Dementia and Alzheimer or those who struggle with mobility. As I did research, I saw that these facilities existed but I knew I could be more successful and provide better care. We opened the doors to The Senior Club in 2012.

**What challenges have you faced in your business?**

There are two main challenges I face in my business. The principal challenge faced in my business is the daily control and supervision of participants with various diseases. While it is rewarding to see the benefits of our work, it still remains a struggle to help them while supervising staff and running the daily operations of the business. Hiring professional employees who are properly trained does alleviate most of the burden but I will always be passionate about being present and helping our seniors. The second challenge I am facing is one of those good-and-bad type of situations. Currently, we are at our maximum capacity and cannot admit anyone into our program until someone else leaves. We have a waiting list of over thirty people waiting to get accepted into our facility. While this is seen as good, it has been challenging to expand our facility so we can accommodate more people. I was able to secure a second unit right next to my original space. Recently, I secured the unit two doors down and am hoping to secure the two units between us in the next two years to have a total of five units all connected. By expanding the overall size of our facility, I can then get permission to accept more participants to our care.





### What's your schedule like, what's a typical day for you?

We say that our hours of operation are from 9:00am to 5:00pm but as any small business owner will tell you, that hardly accounts for our whole day. In addition to the work we do at our location, we also provide transportation to all participants. This means that we use our fleet of vehicles to drive to wherever our participants live, pick them up and take them to our daycare center, and then take them all home at the end of the day. Additionally, we also provide meals and snacks throughout the day. We keep quite busy.

### Do you have any employees?

Yes, while Lizbet and I would like to take all the credit, the truth is that we are successful because we have put together a strong team that supports our mission. We currently have six full-time and five part-time employees. We will be looking to hire more staff once we increase our space to accommodate more participants.

### What's the best thing about being self-employed?

The best part about being self-employed is the freedom it provides to be the boss. Establishing my own policies, organizing the business in my vision, and running things how I see fit is definitely my favorite part of self-employment.

### What's the best compliment you've ever received from a client?

I can't single out a single a compliment but I will say that it is a great feeling when our seniors express to us that our facility is their "home away from home." It is also special when the family members of the seniors express their gratitude and tell us how important our work is to their lives.



### What's the most important piece of advice you would give to someone starting their own business?

I would say that starting a business is hard work, so hard in fact that I feel you need to be motivated and passionate about what you are doing and not just focused on potential profits. You should state your mission, identify your services, state your goals in a clear and concise manner and work hard.



## Want to be Featured in Upcoming Issues?

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## Learn More in the NASE Member Directory

Learn more about other Self-Employed businesses in the **NASE Member Directory**. You can add your own company to the NASE Member Directory in up to three categories at no charge – it is a free benefit to NASE members.



# ADMINISTRATION PROPOSES 21ST CENTURY RETIREMENT SYSTEM

In November the Administration launched the **MyRA retirement tool** encouraging individuals to establish retirement accounts, however, President Obama has now focused his attention on small employers (with less than 100 employees) who currently do not offer a retirement plan to their employees.

For small employers, the challenges tied to administering retirement plants have proven to be complex and in some cases, the fiduciary responsibility for proper plan administration is a liability that a small employer cannot justify.

Yet, in the President's fiscal year 2017 budget (**FACT SHEET: Building a 21st Century Retirement System**), his administration proposes several actions to encourage and potentially force small employers to offer retirement accounts, including:

- ➔ Make it easier for employers to create pooled 401(k) plans to lower cost and burden.
- ➔ Provide tax cuts for businesses that choose to offer more generous employer plans or switch to auto-enrollment.
- ➔ Expand retirement savings options for long-term, part-time workers.
- ➔ Proposed to automatically enroll workers without access to a workplace plan in an IRA.

While the intention of the President's proposal is to create additional opportunities for Americans to save for their retirements, we are cautious as to the legal and paperwork burden this could place on small business owners. The NASE continues to monitor action on the proposal and will work with our members when the time comes to draft a policy statement that represents our members.

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