

Fishing Information Newsletter

News You Can Use from the Internal Revenue Service

Volume 3, Issue 10

Circulation 458

November/December 2001

Message from the Editor

This edition of the Fishing Information Newsletter ("FIN") will be my last as the editor. I have enjoyed serving as the editor since April of this year, and have appreciated your comments, questions, and suggestions for articles. As I've said before, it is our goal to make the FIN as useful to you as possible; your input is a great help in reaching this goal.

Nancy Burke, an Anchorage, Alaska Revenue Agent who is very experienced with fishing issues, will be serving as the editor until the Taxpayer Education & Communications (TEC) section of the Small Business/Self-Employed Operating Division assumes responsibility for the FIN. This is expected to take place in May 2002. Nancy can be reached at the email and regular mail addresses, or the phone number listed below.

Joan Olmstead
Former Editor, Fishing Information Newsletter

Please send us your topic ideas and questions....

E-mail: nancy.j.burke@irs.gov or
fishing.assistance@irs.gov

Mail: Internal Revenue Service
Attn: MS A151-Nancy Burke
949 E. 36th Avenue
Anchorage, AK 99508

Phone: (907) 271-6900

Estimated Tax Penalty Revisited – IRS Will Abate Erroneously Assessed Penalties

In the August 2001 edition of the FIN we discussed the criteria for computing the estimated tax penalty for farmers and fishers and explained what you should do if you were assessed a penalty that you feel

is incorrect. If you haven't found the time to check into a penalty that was assessed, we have some good news that may save you some time. The cause of some of the incorrect penalty assessments was a computer program that didn't properly identify returns filed by fishers or farmers. The IRS has corrected its computer program so that this problem will not happen again.

More importantly, the IRS will be removing incorrectly assessed estimated tax penalties for the tax years ending December 31, 1998, 1999, and 2000. We will mail a letter to affected taxpayers the second week of December explaining the penalty removal. Also, affected taxpayers will receive separate notices explaining how their account was adjusted for each year that was adjusted. This procedure will require no action on the fisher's part. Of course, any fisher whose estimated tax penalty isn't abated in December 2001, but feels it should be, should follow the guidance and procedures in the August 2001 FIN.

Reasonable Compensation for S Corporation Shareholders – June 2001 FIN Article Feedback

In response to our June 2001 article we have had questions about the correct classification of income for services performed by corporate officers. In our June article we stated that a corporate officer could receive wages for corporate officer services and receive self-employment crew shares for services performed while on the boat (assuming the crew shares meet all the requirements contained in the February 2001 FIN for treating the crew member as self-employed). The question that has been raised is: When a corporate officer performs officer services and is entitled to receive compensation for these services, should all compensation paid to the corporate officer, including those labeled "crew shares," be treated as wages? We will soon be requesting techni-

cal assistance on this issue and will notify you of the correct treatment when received.

Offers In Compromise (OIC) – Online Assistance

In the October FIN we provided a detailed explanation of the Offer in Compromise (OIC) process. FYI, the IRS has a five-step online OIC program that will help determine if you are eligible to submit an OIC and what information you will need to complete your submission. Click on the following link and the program will walk you through the OIC submission process:

<http://www.irs.ustreas.gov/smallbiz/practitioner/oic.htm>.

Recordkeeping Guidelines

*By Judy Pearson, Revenue Agent
Anchorage, AK*

It's getting close to the end of the year and you may be already thinking about that return you need to file for the 2001 tax year. We thought you might like some information on recordkeeping procedures to get your "books and records" in order to help make the return preparation go smoother. In addition, you can start off on the right foot for the 2002 tax year if you incorporate these guidelines into your recordkeeping practices. Also, if you keep timely and accurate records, you will have support to show the IRS if your tax return is ever examined.

Kind of Records to Keep: Except in a few cases, the law does not require any special kind of records. You can choose any recordkeeping system suited to your business that clearly shows your income. If you are in more than one business, you should keep a complete and separate set of records for each business.

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.

Supporting Documents: Fish sales, crew shares, and other transactions you have in your business will generate supporting documents. Supporting documents include fish tickets, paid bills, invoices, receipts, deposit slips, and canceled checks. These documents contain the 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:

- Fish tickets and fish ticket summary reports.
- Cannery statements.
- Bank deposit slips.
- Form 1099-MISC.
- Receipts books.

Purchases: Purchases are the items you buy and resell to customers. This is generally not applicable for a commercial fisherman. However, if applicable, your supporting documents should show the amount paid and that the amount was for purchases. Documents for purchases include the following:

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

Expenses: Expenses are the costs you incur (other than purchases) 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:

- Cannery statements.
- Crew settlement agreements.
- Canceled checks
- Cash register tapes.
- Account statements.
- Invoices.
- Credit card sales slips.

- Petty cash slips for *small* cash payments.

Petty Cash: 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.

Assets: Assets are the property such as boats and gear that 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 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.

Documents that may show some of this information include the following.

- Purchase and sales invoices.
- Real estate closing statements.
- Canceled checks.

Allocating total cost: If you use an asset for both business and personal purposes, only the business portion of your total expenses for this asset are deductible. Therefore, you must make an allocation between the business and personal use to determine the deductible business expense. For example, if you use your pick-up truck for both business and personal purposes, you must allocate your expenses, such as depreciation, insurance, repairs/maintenance, gasoline, tires, etc. between business and personal use. Keeping a log of your business and personal use of the truck will provide you with the information needed to make the allocation based on miles driven for each purpose. The log for certain assets is more appropriately kept in terms of hours used for each purpose, such as a computer used in your business and for personal purposes.

Example. You use a pick-up truck only for personal purposes during the first 4 months of the year as well as the last 4 months of the year. During these 8 months you drive the truck 8,000 miles for personal purposes. During the months of May, June, July, and August, you drive the truck a total of 5,000 miles of which 4,000 miles are for your fishing business. This gives you a business use percentage of 31% ($4,000 \div 13,000$) for the year.

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 is a list of acceptable account statements.

If payment is by check, then the statement must show: check number, amount, payee's name, and date the check was posted to the account by the financial institution.

If payment is by electronic funds transfer, then the statement must show: amount transferred, payee's name, and date the transfer was posted to the account by the financial institution.

If payment is by credit card, then the statement must show: amount charged, payee's name, and transaction date.

Recording Business Transactions: A good record-keeping system includes a summary of your business transactions. Business transactions are ordinarily summarized in books called journals or ledgers. You can buy them 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 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 (crew) compensation record.

Business checkbook: One of the first things you should do when you start a business is open a business checking account. You should keep your business account separate from your personal checking account.

The business checkbook is your basic source of information for recording your business expenses. You should deposit all daily receipts in your business checking account. You should check your account for errors by reconciling it. Consider using a checkbook that allows enough space to identify the source of deposits as business income, personal funds, or loans. You should also note on the deposit slip the source of the deposit and keep copies of all slips.

You should make all payments by check to document business expenses. Write checks payable to yourself only when making withdrawals from your business for personal use. Avoid writing checks payable to cash. If you must write a check for 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, you should make an adequate explanation in your records at the time of the payment.

Computerized System: There are computer software packages that you can use for recordkeeping. They can be purchased in many retail stores. These packages are very useful and relatively easy to use; they require very little knowledge of bookkeeping and accounting.

If you use a computerized system, you must be able to produce sufficient legible records to support and verify entries made on your return and determine your correct tax liability. To meet this qualification, the machine-sensible records must reconcile with your books and return. These records must provide enough detail to identify the underlying source documents.

You must also keep all machine-sensible records and a complete description of the computerized portion of your recordkeeping system. This documentation

must be sufficiently detailed to show all of the following items.

- Functions being performed as the data flows through the system.
- Controls used to ensure accurate and reliable processing.
- Controls used to prevent the unauthorized addition, alteration, or deletion of retained records.
- Charts of accounts and detailed account descriptions.

Travel, transportation, food, entertainment, and gift expense: Special recordkeeping rules apply to these expenses.

You should keep adequate records to prove your travel, transportation, food, entertainment, and gift expenses or have sufficient evidence that will support your own statement. You must generally prepare a written record for it to be considered adequate. This is because written evidence is more reliable than oral evidence alone. However, if you prepare a record in a computer memory device with the aid of a logging program, it is considered an adequate record.

Adequate records. You should keep the proof you need in an account book, diary, statement of expense, or similar record. You should also keep documentary evidence that, together with your records, will support each element of an expense.

Documentary evidence. You generally must have documentary evidence, such as receipts, canceled checks, or bills, to support your expenses. However, documentary evidence is not needed for your travel, entertainment, business gift, or local transportation expenses if the expense is less than \$75. This \$75 exception does not apply to lodging (all lodging documentary evidence is required regardless of the amount).

Adequate documentary evidence. Documentary evidence ordinarily will be considered adequate if it shows the amount, date, place, and essential character of the expense. For example, a hotel receipt is enough to support expenses for business travel if it has all of the following information.

- 1) The name and location of the hotel.
- 2) The dates you stayed there.
- 3) Separate amounts for charges such as lodging, meals, and telephone calls.

A restaurant receipt is enough to prove an expense for a business meal if it has all of the following information.

- 1) The name and location of the restaurant.
- 2) The number of people served.
- 3) The date and amount of the expense.

If a charge is made for items other than food and beverages, the receipt must show that this is the case.

In addition to the documentary evidence described above, you must also establish the business purpose of your travel and the business purpose of the meals.

Proving business purpose. You must generally provide a written statement of the business purpose of an expense. However, the degree of proof varies according to the circumstances in each case. If the business purpose of an expense is clear from the surrounding circumstances, then you do not need to give a written explanation.

Canceled check. A canceled check, together with a bill from the payee, ordinarily establishes the cost. However, a canceled check by itself does not prove a business expense without other evidence to show that it was for a business purpose.

Duplicate information. You do not have to record information in your account book or other record that duplicates information shown on a receipt as long as your records and receipts complement each other in an orderly manner.

Timely-kept records. You should record the elements of an expense or of a business use at or near the time of the expense or use and support it with sufficient documentary evidence. A timely-kept record has more value than a statement prepared later when generally there is a lack of accurate recall.

You do not need to write down the elements of every expense on the day of the expense. If you maintain a log on a weekly basis which accounts for use during the week, the log is considered a timely-kept record.

Allocating total cost. If you can prove the total cost of travel or entertainment but you cannot prove how much it cost for each person who participated in the event, you may have to allocate the total cost among

you and your guests on a pro rata basis. An allocation would be needed, for example, if you did not have a business relationship with all of your guests.

How long to keep records. You must keep your records for as long as they are important for the federal tax law.

Keep records that support an item of income or a deduction appearing on a return until the period of limitations for the return runs out. (A period of limitations is the period of time after which no legal action can be brought.) For assessment of tax you owe, this generally is 3 years from the date you filed the return. Returns filed before the due date are treated as filed on the due date.

For filing a claim for credit or refund, the period of limitations is generally 3 years from the date you filed the original return or 2 years from the date you paid the tax, whichever is later. However, if a claim is due to a bad debt deduction or a loss from worthless securities, the period of limitations is 7 years.

If you did not report income that you should have reported on your return, and it is more than 25% of the income shown on the return, the period of limitations does not run out until 6 years after you filed the return. If a return is false or fraudulent with intent to evade tax, or if no return is filed, an action can generally be brought at any time.

You may need to keep records relating to the basis of property longer than the period of limitations. Keep those records as long as they are important in figuring basis of the original or replacement property. Generally, this means for as long as you own the property and, after you dispose of it, for the period of limitations that applies to you.

Copies of returns. You should keep copies of tax returns you have filed and the tax forms packages as part of your records. They may be helpful in amending filed returns or preparing future ones.

Need Back Issues?

Back issues of the FIN are available. Please feel free to request them by Month/Year or Volume Number

through any of the email or regular mail addresses on the first page of the FIN.

Tax Assistance Hotline, Forms Hotline, Internet Access

Taxpayer Assistance

Phone Numbers:

(800) 829-1040

(800) 829-4059 TTY/TDD (Hearing Impaired)

Tax Forms and Publications

(800) 829-3676, seven days a week, 24 hours a day.

Order free tax forms and publications.

IRS Internet Access

World Wide Web: www.irs.gov

The IRS Web Home Page allows convenient access to tax information 24 hours a day. The Web Site provides tax forms with instructions, publications, the latest tax law changes, and much more information for individuals and businesses.

If you change your E-mail Address...

If you are receiving this newsletter electronically and you have changed your Internet provider, please remember to send us a quick note advising us of any change to your e-mail address.



Department of the Treasury
Internal Revenue Service
Publication **3432 (12/01)**
Catalog Number **26188F**
www.irs.gov