How Owners Get Hit With Huge Bills For Back Taxes, Interest, and Penalties

The reason: Improper and undocumented travel, meals, entertainment, lodging, and auto deductions — some of the highest IRS audit areas. Compounding the problem are poor recordkeeping, non-existent receipts, and non-compliance with the rules, all of which are discovered by the IRS several years after you already filed your business and personal tax returns. That means the amount due the IRS often is double or triple the original taxes payable because it includes interest, penalties, a 20% negligence penalty, and possibly a 75% additional penalty if you *intentionally* overstated your deductions.

That's what happened to one business owner who had **$18,000** in deductions denied by the IRS. The final tax bill was broadened to include denied deductions for two other family members employed by the business. The IRS' tough documentation rules also apply to family members who work for the company. By family, the IRS means your parents, children, grandparents, grandchildren, spouse, and siblings. They also must itemize and fully document their expenses. In the end, with interest, penalties, and three family members included, the tax bill for this owner was **$62,000**, an **increase of $44,000** above the original denied deductions of $18,000.

With that warning, take special care to comply with the IRS rules. To help you with that task, we compiled this list of the most common mistakes business owners make in claiming deductions and complying with the rules. These **mistakes** also happen to be the areas most closely scrutinized by the IRS.

- Owners don't establish *written* company policies for everyone in the company to follow.
- They don't make an effort to learn the rules, so they can't comply with them. They rely *solely* on their accountants who in turn rely on the numbers provided to them.
- They don't require their employees to fully document expenses with receipts, purpose, date, etc. Or, they let months go by before requiring expense

vouchers from the employees.

- They don't demand that a *mileage log* be kept on auto use and that it indicate the purpose of the auto use and the business and personal mileage use for *each* trip.
- They take their spouses on business trips and deduct all expenses.
- They don't keep *contemporaneous* records. They reconstruct records *only* after an audit notice from the IRS; that's asking for trouble. The IRS has ways of spotting *after-the-fact* recordkeeping.
- They attend a workshop or business convention and deduct a full week of expenses even though the workshop lasts only two days and includes only a few hours of education.
- They use a company-owned car to commute to and from work and don't account for that personal use or reimburse the company.
- They don't personally spend time reviewing their business tax returns. They simply sign off on the accountant's deductions on all travel, entertainment, and auto use.
- They elect to pay business expenses out of their own pocket and deduct them on their personal tax return.
- They don't analyze tax options to determine which achieve greater tax savings. *Prime examples:* The choice of either the standard mileage or actual cost method for deducting auto expenses, and the choice of which year to elect and take special depreciation options.

Start to correct those mistakes now b y adopting a *written* company policy which requires full documentation of expenses: (a) within a specific time period (usually monthly) and (b) before the employee gets reimbursement. □

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