

Profit With An Organized Plan

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Poor recordkeeping is a major cause of small business failure! The U.S. Small Business Administration (SBA) says so. Dun & Bradstreet agrees with the SBA by claiming that 80% of all business failures are due to poor records. One university study concluded that 40% of retailers surveyed did not keep proper records. Poor recordkeeping also means more taxes, more IRS problems and more costs to you.

Your business plan of success. All successful people have a written business plan. All successful companies keep financial records so they can control, improve and develop their business. Therefore, what you will learn in this section is a system that gives you much more control of where your time is going and where you are spending your money. Recordkeeping (“RK”) need not be the time-consuming, tedious drudgery of past years. We are fortunate that we have timesaving tools such as *Quicken*, *Daytimer*, *TurboTax* and my timesaving tips (discussed later) that make RK much easier.

RK should become a habit and this guide will set up good RK habits for you.

In this section, the following, along with planning strategies, are discussed:

A. SUPERIOR BUSINESS ORGANIZATION CAN SAVE YOU THOUSANDS OF DOLLARS AND AT THE SAME TIME GIVE YOU A 3-FOLD BENEFIT

B. THE LOSS OF THESE DEDUCTIONS IS COMPOUNDED FURTHER BY

C. LET THE GOVERNMENT PAY YOU FOR YOUR GOOD RECORDS!

D. TIME-SAVING STRATEGIES FOR BUSINESS ORGANIZATION

E. RECOMMENDATIONS PERTAINING TO TYPE OF EXPENDITURE

F. HOW LONG TO KEEP RECORDS - SOME GENERAL GUIDELINES

G. THREE FINAL COMMENTS ABOUT RECORDKEEPING

1. SEPARATE BUSINESS ACCOUNT

2. LOST RECORDS

3. DON'T WAIT TO BE AUDITED TO START RECORDKEEPING --UNLESS YOU LIKE HORROR STORIES!

A. SUPERIOR BUSINESS ORGANIZATION CAN SAVE YOU THOUSANDS OF DOLLARS AND AT THE SAME TIME GIVE YOU A 3-FOLD BENEFIT:

(1) It implements your business plan - With RK you are obtaining every possible tax deduction, which is another form of cutting expenses (such as taxes, a big expense!)

Keeping records also tells you what works, and what doesn't work for your *business*.

(2) It maximizes your deductions - Many people miss out on great deductible opportunities by failing to log in routine expenses such as auto supplies, office supplies, tolls, business postage, incidental expenses on business travel (such as tips & meals).

(3) Keeps you out of trouble with the IRS (as it documents your business expenses) -

Failure to maintain adequate records can result in substantial negligence penalties.

ALL of the above benefits lead to *MORE DOLLARS IN YOUR POCKET*.

The cost of poor tax records is *significant*: This is especially so with auto expenses. You must keep records substantiating the business use of your auto. You must prove:

___1. The amount and date of each expenditure for the car. (Examples: the cost and date of the acquisition or lease, maintenance, repairs, gas, etc. Bills and receipts must be kept for these types of expenses.)

___2. The date for each business-use of the car.

___ 3. The business mileage for each trip and total mileage for the year.

___ 4. The purpose of business trips.

Auto expenses are one of your biggest deductions and poor recordkeeping can be *costly*:

- ◆ Loss of the *accelerated* depreciation methods to write off automobile expenses if the business use of your car is 50% or less.
- ◆ Loss of first-year expensing if the business use of your car is 50% or less.
- ◆ Loss of other auto expenses as deductions -- When your business-use percentage goes down so does the deduction of other auto expenses such as gas, repairs, insurance, interest, lease payments and many others.
- ◆ Loss of *all* auto deductions if your records are very poor.
- ◆ Loss of *other* deductions such as travel, entertainment, etc.

B. THE LOSS OF THESE DEDUCTIONS IS COMPOUNDED FURTHER BY:

(1) YOUR MULTI-LEVEL SCHEDULE C TAX BRACKET.

(2) THE LOSS OF DEDUCTIONS IN FUTURE YEARS -- From section 1, remember the impact of the time value of money as it relates to the future. Also, if the IRS audits you and finds undocumented deductions, they generally do not stop at one year. They take “no prisoners” and will audit more years and disallow more deductions.

(3) PENALTIES & INTEREST -- Past due taxes equal additional penalties & interest.

By themselves, many of these deductions are big-ticket items, not to mention their value in your business tax bracket for the years to come. Accordingly, there is a lot at stake here and the monetary value of good record organization cannot be overemphasized.

C. LET THE GOVERNMENT PAY YOU FOR YOUR GOOD RECORDS!

EXAMPLE: You are in a tax bracket of 40%. Because of your good business organization you come up with another \$2,000 of deductions. In the 40% bracket these deductions equate to \$800 in tax savings or a government pay check as a reward for your entrepreneurial organization. If the recordkeeping took you (or your assistant) an unlikely 4 hours,* you would have been paid a *nice* \$200 an hour from the government.

*[Note: With the timesaving tips in this section, it will take you much less time, which means more dollars in your pocket.]

AND REMEMBER -- Business organization is the single best weapon in an IRS audit. *"An ounce of recordkeeping is worth a pound of argument!"*

D. TIME-SAVING STRATEGIES FOR BUSINESS ORGANIZATION

STRATEGY 1: USE THE "DAYTIMER" -- This is a daily, monthly and annual calendar\appointment book (diary) that has a separate insert for each month. It has 2 pages for each day, leaving plenty of room for appointments, planning, and recording *tax-deductible* cash expenditures, including business entertainment. It has an address book,

room for notes and memos, calendars etc. It also has a pen, which I find extremely convenient. I like the monthly inserts because each month before I change the insert, my assistant can first summarize my business cash expenditures on a computer summary sheet (such as Quicken), which then becomes part of my tax return and financial statements. Your Daytimer should be your constant business companion so it will be available when you need it. To purchase Daytimer, call 1-800-225-5005. You also might try other recordkeeping system that may be advertised in business magazines. There is also the *Palm Pilot*.

TIP: Entries in your daily dairy do not have to be exactly contemporaneous, but they should be made as near the time of the expenditure as possible [IRS Regulation 1.274-5T(c)(2)(ii)]. Your Daytimer (diary) can be put on a computer, IRS Regulation 1.274-5T(c)(2)(ii)(C)(2).

STRATEGY 2: USE THE "DOWN-TIME APPROACH" -- This is something I use all of the time and it works well in reaping valuable deductions I would otherwise miss. You too can use what I call "down-time" to make business-activity entries in your dairy. You can also record out-of-pocket cash expenses during the downtime. Examples of down-time, that we ALL run into no matter how busy, are the following: *waiting* at a drive-in bank, *waiting* at a gas station, *waiting* in a traffic jam, *waiting* for a customer or *waiting* for whatever.

Tax Tip: For those of us who live in cold winter climates, a good time to catch up with some valuable recordkeeping is in January when you are stuck at home in a winter storm. You can sum up the year and in April file your extension.

STRATEGY 3: USE "P-R-E-S-T-O"! - Combined with the downtime approach, use the Italian word for quick, "presto," which is a mnemonic or memory jogger for frequent cash business expenses such as the following:

- P - Parking (or paper, pads, pens)
- R - Refill (Gas, oil, lube, wash or "receipts")
- E - Entertainment (don't forget the 5 W's)
- S - Supplies (office, auto, etc.)
- T - Tolls (or "tools" of your trade or for your car)
- O- Other

When you pull in a gas station, car wash, bank, etc. and incur some down time, automatically think of "*PRESTO*," don't waste time, start making entries in your dairy of cash expenses that you have incurred. The "R" in Presto also stands for receipts, which you should obtain and attach to the appropriate page in your dairy.

TIP: You could vary this mnemonic toward your particular activities. For example, perhaps you generally do not incur tolls in your business travels, so change the "T" to mean Tools, such as marketing tools or tools (such as wrenches) for your business car. You may not generally incur parking expenses, so the "P" could be for Pad, Paper, Pens, Pencils, and other stationery. Use any variation or combination that fits your needs. No matter how you use it, I can only tell your from experience it works to increase your deductions, PRESTO!

TAX TIP: Keep an envelope in your car. Each day as you start your car, let the engine warm up a bit so you can make your entries, including your odometer reading and places you intend to go. Use the envelope to hold the receipts you acquire during the day. Start a

new envelope every month. On each envelope, write the month and year.

STRATEGY 4: ROUND-OFF NUMBERS -- For example, your car wash was \$7.50, use \$8. You purchased supplies for \$12.14, use \$12. This is easier and saves time.

STRATEGY 5: APPLY THE \$25 NO-RECEIPT RULE. BUT GET RECEIPTS IF YOU CAN: For expenditures under \$25 (i.e. \$24.99 or under), you are not required to have a receipt. This is a time-saver. However, many tax experts advise that you use this rule only if you cannot get a receipt. Otherwise, you should obtain bills, invoices or receipts for everything if you can. *Reason:* In the event of an IRS audit, the auditor is much less prone to question a professional who keeps and files receipts for everything.

REMINDER: With or without the receipt, record *all* cash expenditures in your diary.

STRATEGY 6: USE BUSINESS CODE ABBREVIATIONS FOR BUSINESS PURPOSES & BUSINESS RELATIONSHIPS -- Below are suggested business-purpose codes that are designed for self-employed real estate agents. Even if you are not a real estate agent, you could use some of them or create similar ones adaptable to your business so you can make your diary entries *quick, easy and consistent*. You also could use them for business entertainment, gifts and travel.

BUSINESS-PURPOSE CODES:

BD - Board of Realtors
BM - Business meeting
BO - Branch office

BUSINESS-RELATIONSHIP CODES:

CL - Client
CU - Customer
B - Buyer

BP - Buyer presentation
CE - Continuing ed (seminars, etc.)
CMA - Competitive market analysis
DP - Document pickup
F - Farm area
LP - Listing presentation
OH - Open house
PA - Present agreement
SH - Sample home
SP - Show property (or selling)
ST - Settlement
T - Tour (or caravan)

OTHER CODES:

H - Home
RE - Real Estate

S - Seller
BA -Business Associate
CPA - Accountant or tax advisor
ESQ - Attorney
I -Investor
LO - Loan Officer
MC - Mortgage Company
PR - Prospect
REF - Referral
R -Realtor
TC - Title company

OTHER CODES:

INV - Investment property
MI - Mileage

EXAMPLE: You are a real estate agent who traveled to do a listing presentation for the Smith's, a prospective client at 204 Oak St. Your entry might read, LP, Smiths, PR, 204 Oak." (If they signed the listing then the "PR" is "CL" for client.)

These codes should be acceptable to the IRS [see IRS Regulation 1.274-T(c)(2)(ii)(B)].

These business codes do save time.

- They do not take much to get use to.
- Once you use them it's quicker and easier, especially when you use them a lot.
- If the situation applies, you could use more than one code for a particular entry.
- It's a good business checklist reminder.

- It disciplines you into making the entry a *habit*.
- Its all part of your business plan of success.

You should make a copy of the code index and perhaps have it reduced so it can fit into your dairy, on your dashboard or other convenient place where you can easily refer to it. After you use it for a while you will have it memorized and will not even have to look at it. You can make your entries with "PRESTO" speed.

STRATEGY 7: ONLY RECORD FREQUENTLY-USED SET ROUTES ONCE AND USE ABOVE CODES FOR FREQUENT ROUTES -- Typically you may have the same frequent business stops throughout the day. Record once the mileage distance of these common set routes. [IRS Regulation 1.274-5T(c)(2)(ii)(C)(1)]. Do this *once* in a separate notarized statement. The notarized statement would simply have a list of the common set routes, the round-trip mileage of each route, your name, signature and a notarized seal. I would measure the mileage using the round-trip distance from your office, not your home, as this is clearly a business trip. The IRS may argue that travel from you home to a business stop is not deductible (although this argument can be challenged). With this strategy, it would also be helpful if you used business codes as discussed under the previously strategy.

STRATEGY 8: COMBINE BUSINESS TRIPS INTO ONE ENTRY -- A round-trip of several uninterrupted business stops may be accounted for by a single record [IRS Regulation 1.274-5T(c)(6)(i)(C)]. For example, you are a real estate agent and in one trip you will be doing document pickups (DP). You may pick up the sales agreement from the buyer (DP), run it to the seller for their signature (DP) and run a copy to the mortgage company (DP). The three trips can be recorded

as one entry “3 DP’s - 20MI.”. You can use this strategy along with your own business codes for any type of business.

STRATEGY 9: USE A 3-MONTH "SAMPLING" FOR

BUSINESS AUTO TRAVEL -- You are allowed to use a 3-month “sample” period to compute your business mileage for the year, provided it is representative of the full tax year. [IRS Regulation 1.274-5T(c)(3)(ii)].

- ⇒ For 3 months of the year, log in your dairy each of your business trips with mileage. Record your odometer reading for mileage at the beginning & end of the 3 months you select. You can use business codes.
- ⇒ You should select the 3 months where you are the busiest so you can get a high representative business-use of your auto. Keep in mind that it's only for 3 months and you will be using my time savers, such as the downtime approach and using assistants, discussed later in this section. Also, once you do it for the first year, subsequent years will be much easier. You can do it on a computer. As per Strategy 7, include here the mileage for the set business routes for the total 3 months. Again, you do not have to record mileage every time you go to the set business destination,
- ⇒ Do the simple math for the 3-month sampler -- For the sample, add up all of the business mileage for the 3 months and divide it by the total mileage (business & personal) for the same 3 months and the resulting percentage is your business-use of the car.

⇒ For the rest of the year, just make brief entries in your dairy and keep corroborating documents such as business related contracts, agreements, correspondence, etc.

ALERT: This sampling method only applies to auto, *not* to entertainment or

Out-of-town travel, both of which are covered later in this section.

COMMENT: Combining the above strategies can be a *powerful* way to save valuable time, secure valuable deductions, be organized and, still meet IRS requirements.

STRATEGY 10: USE "QUICKEN" -- This is an inexpensive but user-friendly computer software program for organizing records for tax planning and preparation. Recordkeeping can be done in minutes.

Quicken can be interfaced with *TurboTax*.

TIP: Your business diary can be put on a computer, IRS Reg 1.274-5T(c)(2)(ii)(C)(2)]

STRATEGY 11: USE *TURBOTAX* -- This is are inexpensive and easy-to-use 1040 software program for income tax preparation. There are also business programs for partnerships and corporations. They save hours of form preparation, tedious computations and carrying over of amounts to and from different schedules. They help ensure accuracy, prevent math errors and can save you tax preparation fees. Even if you have a tax advisor, you still can use these to control your financial situation and still save on fees. Besides *TurboTax*, there other tax preparation programs you can check out in office supply stores.

**STRATEGY 12: DON'T YOU DO THE RECORDKEEPING...
USE OTHER PEOPLES TIME & TALENT ("OPT&T")** -- Don't

get bogged down in unproductive detail. It will soak up valuable time that you could be using to earn more income. Instead, *leverage* your time by employing a personal assistant (who could be your children or spouse) to take care of recordkeeping and other clerical duties, using *Quicken & TurboTax*. You can receive additional income tax benefits by having family members as employees in your business.

STRATEGY 13: USE CREDIT CARDS -- By using credit cards you have the necessary receipts and canceled checks. This is especially so for auto expenses and entertainment.

RECORDKEEPING TIP:-- Use the credit card companies that send annual tax summaries: Here you have your tax-related expenses already totaled and classified. Where you do not use a credit card, obtain a receipt, unless is not practical to do so, such as a toll, parking meter or one is not available.

***ALERT:** The credit card company may not send out the tax summaries automatically. In January or February following the tax year call them and remind them to do so. Follow-up with them.

STRATEGY 14: DO RECORDKEEPING FREQUENTLY! -- With the help of your assistant, do your recordkeeping frequently, preferably *daily*. At the very least, do it every month instead of waiting until the end of the year when everything piles up, when it then takes 5 times as long to do! With the above shortcuts it's a snap. This not only saves time but also keeps you *current* on your business financial condition. Remember, it's business organization that you are really doing. One thing is for sure, NEVER WAIT UNTIL YOU ARE AUDITED, UNLESS YOU LIKE HORROR STORIES!

TAX TIP: The tools of recordkeeping (such as Quicken and hiring an assistant) are *tax deductible* on your business schedule, such as Schedule C. Therefore, the government will subsidize a good portion of your business organization as an entrepreneur. The combination of tax strategies and good business organization becomes *money-management* at its best. The deduction checklists in App. A are also time-savers.

ADDITIONAL SECONDARY DOCUMENTATION FOR BUSINESS AUTO TRAVEL ARE:

WRITTEN POLICY -- It should be documented in writing in your corporate or LLC minutes or other written evidence that you must substantially use your car for your business activities. It may even help to put in a recommended percentage of business use for your car.

COMPANY NAME -- Have your company name and address on the car itself (take a picture of the car).

PERSONAL-USE CAR -- Have at least another car for personal purposes.

CAR AT OFFICE -- Keep your car at the office instead of at home (if practical).

CREDIT CARDS\RECEIPTS -- Discussed under Strategy 13 above.

ALERT ON THIS SECONDARY DOCUMENTATION: Keep in mind the above are corroborating or secondary supporting evidence. The "slam dunk" primary proof is the Daytimer/diary. In other words, if you want to *fully maximize* your valuable auto deductions,

you need the primary proof of a diary. With our many time savers along with your business plan, it's no big deal.

E. RECOMMENDATIONS PERTAINING TO TYPE OF EXPENDITURE

1. AUTO: You must disclose information about auto recordkeeping on your tax return. The IRS will ask questions on your tax return. These questions must be answered truthfully. On page 2 of Schedule C, or IRS Form 4562 (Depreciation Schedule) , you must answer the following:

*Do you have evidence to support the business use claimed ? ___Yes
No_____*

If "Yes," is the evidence written ? ___Yes No_____

CAUTION: If you answer “no” to any of these questions, you are inviting an IRS audit. “Yes” is the better answer, but you must be truthful.

In addition, you must report the following about your business auto:

- 1. The total mileage driven*
- 2. Business mileage driven,*
- 3. Commuting mileage driven*
- 4. Other personal mileage driven*
- 5. Date placed in service, use of other vehicles*
- 6. Personal use for off-duty hours*
- 7. Percentage of business use.*

If you follow the strategies in this section to develop and implement your business plan, you should have no problem answering the above questions.

TAX TIP: NEVER CLAIM A 100% BUSINESS USE OF YOUR CAR UNLESS YOU WANT AN INVITATION TO AN AUDIT!

The absolute highest you should go is 95% and that is assuming you follow my planning strategies.

SAME RULES FOR LEASED CARS -- All of these same rules, including answering the above questions, pertain to leased autos as well. (See Section 6A). (For more about auto deductions, see the beginning of this section and Sections 6A, 7 & 8.)

2. BUSINESS ENTERTAINMENT: According To Internal Revenue Code Section 274(d), a daily diary such as the "Daytimer" must be maintained and must state ALL of the following:

1. Person(s) entertained
2. Amount of entertainment
3. Place of entertainment (restaurant, theater, etc.)
4. Date and year of entertainment
5. Business purpose of entertainment.

That is, the 5 W's: "*Who, What, Where, When and Why*" ALL must be documented. Failure to document any one of these elements will bar the deduction, IRS Regulation 1.274-5(c)(1). If the expenditure is less than \$75, a receipt is not necessary. However you still must make the above entries. .

TAX TIP: Make your credit card receipts your contemporaneous diary -- The credit card receipt already has the date, place and amount. You complete the recordkeeping requirement by writing the name of the person entertained, business relationship and business purpose on each receipt or on the appropriate page in your dairy. Either way, the receipt should then be attached to the appropriate page in the dairy or you can set up a "Business Entertainment" file for the applicable tax year.

2A. DEDUCTING BUSINESS GIFTS: Business gifts to clients or prospective clients are limited to \$25 per person. However, the 50% reduction that applies to entertainment does not apply to gifts. You should employ the same procedures as regular entertainment by using the dairy and business codes.

3. TRAVEL OUT OF TOWN: Both IRS agents and the tax courts can be very difficult in allowing travel deductions. However, if you have the right documentation, they will allow it. Accordingly, documentation is essential in substantiating the following items: dates, place, expense amounts, time spent on business and the business purpose of the trip. On the following page is a quick chart to use as a guide to ascertain the documentation needed to substantiate a particular item or items.

<u>ITEM</u>	<u>DOCUMENTATION</u>
DATES & PLACE	Seminar literature, air line tickets hotel bill, correspondence
EXPENSES	Statements, receipts, Daytimer
TIME SPENT* ON BUSINESS & BUSINESS PURPOSE	Daytimer, business agenda, seminar literature & materials, correspondence, reports, phone calls, client files, etc.

***NOTE:** To secure full deductions for travel *to the destination*, you must prove at least 51% of your travel was business related.

4. CELL PHONES: To deduct cell phones, you must have records proving the amount of business use, even if you use it only for business. Only the percentage of business is deductible. To claim first year expensing or accelerated depreciation, the phone must be used at least 51% for business. TIP: Label, which numbers are for business?

F. HOW LONG TO KEEP RECORDS - SOME GENERAL GUIDELINES

- Discard now: Credit card receipts and statements for purchases that either have no tax impact or don't represent important assets; warranties that have expired; receipts or other documents relating to smaller assets you have gotten rid of.
- Keep for 6 years: Tax-related documents. Three years is the general statute of limitations for assessing taxes. But the limitations period is 6 years if there is at least a 25% understatement of income. To be safe, I recommend that you keep all tax records (records that support deductions, W- 2's, 1099's) for 6 years. (Note: There is no statute of limitations in the case of fraud.)
- Keep for 7 years: If you have a net operating loss ("NOL") in a later year, and you carry back the loss to the current tax year, you should keep records for at least 7 years. If you had a bad debt deduction or a loss from worthless securities, keep the applicable records for at least 7 years. See Internal Revenue Code Section 6511.
- Keep until the asset is sold plus 3 years: Records relating to purchases, improvements and tax return treatment of important assets such as real estate should be kept until the asset is sold plus 3

years. This also applies to rolled-over assets. Records relating to investments, IRA's, Keogh plans, pensions, insurance contracts and other contracts should be kept until the transaction has been fully completed and/or all funds have been withdrawn (which sometimes means indefinitely). This would apply to records of all contributions, distributions or rollovers for IRA's and other retirement plans.

- Keep permanently: Copies of *all* tax returns, birth certificates, adoption records, marriage or divorce records, custody agreements and proof of naturalization. Records and returns relating to IRA's and homes should be kept indefinitely.

G. THREE FINAL COMMENTS ABOUT RECORDKEEPING

1. SEPARATE BUSINESS ACCOUNT -- By all means have a business checking account that is totally *separate* from your personal account. Do NOT commingle!

2. LOST RECORDS -- If you do not have adequate records, you can prove the deductions by (1) your own statement that contains specific information about the deduction and (2) Other supporting evidence that is sufficient to establish the deduction. The latter may include a canceled check or credit card statement. The testimony of witnesses or persons entertained relating information about the deduction would be acceptable. [IRS Reg.1.275-5T(c)(3) or the "*Cohan*" rule.]. Also, where you can establish that the failure to produce adequate records is due to the loss of such records through circumstances beyond your control, such as destruction by fire, flood, earthquake or other casualty, you do

have a right to substantiate a deduction by reasonable reconstruction of your expenditures. [IRS Reg.1.275-5T(c)(5)]

3. DON'T WAIT TO BE AUDITED TO START RECORDKEEPING --UNLESS YOU LIKE HORROR

STORIES! I saved the best for last, or I should say the "worst"! In my former years of tax practice before the IRS, I represented many self-employed people. Some were organized, but many were not, which is one reason that prompted me to write this publication. I could tell you many horror stories of those who were not organized and waited until they were audited to write their diary. They (and their staff) spent not hours, but days and evenings writing up daily diaries of auto, travel and entertainment. This is valuable time lost that could be much better used for earning income from your business. Just remember these three simple rules:

- 1) Retroactive recordkeeping is many more times more time consuming and frustrating than consistent up-to-date business organization.
- 2) It's illegal. The entries should be made as near the time of the expenditure as possible, *not* 2 years later.
- 3) IRS agents almost innately have a sixth sense and are able to detect that you retroactively made up the diary and receipts.

RESULT: Disallowance of auto, travel & entertainment deductions as well as the possibility of the imposition of negligence penalties, plus interest, PLUS they will repeat the horror next year as well. (Remember they take no prisoners!)

Today there simply is NO excuse to be a poorly organized business person. So please, develop and implement your *business plan of success* and prevent such disasters from happening to you. No one really cares but you, because it's *your* money!

The referenced sections are from ***The Renaissance Goldmine of Goldmine of Brilliant Tax Strategies Real Estate Investor's***, A Tax Reduction Software System by Albert Aiello & Bill Noll. For more info go to <https://TractionREIA.com/al>

Additional Resources

To implement easily using our forms & systems:

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