

## GOAL SETTING CHART

	What do I want?	What will I do?		What do I need to do?
<b>Date: 1 year from now</b>				
<i>Mine:</i>				
<i>Yours:</i>				
<i>Ours:</i>				
<b>Date: 5 years from now</b>				
<i>Mine:</i>				
<i>Yours:</i>				
<i>Ours:</i>				
<b>Date: 10 years from now</b>				
<i>Mine:</i>				
<i>Yours:</i>				
<i>Ours:</i>				
<b>Date: "Old age"</b>				
<i>Mine:</i>				
<i>Yours:</i>				
<i>Ours:</i>				



How To Manage Your Finances  
By Susan Lee, EA, CFP

Cash flow difficulties are often a major obstacle to a smooth freelance life. ? Cash flow is the money you receive and the money you spend during a given time period.

Here are some tips to allow yourself the freedom to concentrate on what you really want to:

1 Know how much you spend for both business and personal expenses. Look over the past three years of your expenditures. You'll see if your expenses are stable or grow each year. If they grow each year, you must factor that into your calculations of what you need. The trick is to make more than you spend so that you can save the difference and not have to spend your life worrying about paying the bills.

2 See what you've earned over the past few years. Project the coming year. Will you cover what you need to? What happens if you don't? Planning ahead gives you the opportunity to organize what you do so that your cash flow is what you need.

3 Keep track of the money you spend on a monthly basis so that you know you are on schedule. Do the same with what you earn.

4 If you are just starting out, you can know what you spend for personal things. Ask friends in the same field what they spend for business. Since you will be freelancing and not working on a W-2, you will be paying your taxes and both sides of your social Security taxes. Put aside 25% of what you earn in the beginning and adjust this number to what you actually pay. As a freelancer, you will be paying your own health insurance and your own pension.

5 Keep your business expenses separately from your personal expenses. Too many freelancers don't know what they spend on either their business or their personal life.

6 Remember to bill for your work, if appropriate, and follow up in a timely fashion when payment is late – so you will get paid.

7 Keep three to six months of both business and personal expenses in a liquid account so that you can have access to it when for whatever reason you are not getting paid for your work. Don't invest this cushion in stocks or equity mutual funds.

8 *The lower you keep your overhead, the less pressure you will feel about what you need to earn.*

9 In a year where you may think you are earning more, remember to put a higher percentage aside for taxes. Don't consider the extra money as money that you can spend. Make sure it will be available when estimated taxes are due.

Don't expect yourself to be perfect. Getting and keeping your finances into a good balance is a learning process. The more you focus on it, the better you will get at it. Remember that the purpose of all this effort is to lead the life you want.

Susan Lee, EA, CFP, specializes in tax and financial planning for freelancers at (212) 633-1516. She is available for your questions at [www.freelancetaxation.com](http://www.freelancetaxation.com).



**Cash Flow: How You Can Benefit from Knowing Yours and How To Find It Out**  
By Susan Lee, EA, CFP

Too many freelancers feel they are on a perpetual treadmill from which they can't escape. One reason is that they have their eye on their unpaid bills rather than on their cash flow and on their ongoing financial picture.

What is cash flow? Cash flow is as its name sounds -- the flow of cash that is received and the cash that is spent during a given time period.

What good is it?

- Tracking your expenses will reward you when you go to prepare your taxes. You will find that your tax preparation time has decreased.
- You will be able to get a firmer grasp on how you spend your money, at what times of year you spend the most and the least money, and at what times of year your income comes in or doesn't come in.
- You will be able to see how much you are spending and how much you can spend given your income.
- Once you've tracked your income and expenses for several years, you will be able to see if the patterns of earning and spending are consistent. If you know, for example, that January or August are usually slow, rather than sitting by the phone and waiting for it to ring when that is not going to happen, you can make your plans accordingly. You can take a vacation more confident that your business is not going to suffer.
- You can see what is owed on an average monthly basis and know that you must earn enough to cover this amount. You can see when certain larger expenses are paid each year and put money aside for them. This way you won't always be chasing after having to pay what is due.

The first step to understanding your cash flow and your ongoing financial picture is to track your expenses and your income. This means to track and itemize every single penny spent into categories appropriate for seeing how your business runs and for preparing your taxes. While some people write down their expenses into notebooks and then transfer the amounts to spreadsheets, others find that while they still write down their cash expenses into notebooks, they use a software program such as Quickbooks for check writing and record keeping more useful. At the end of the day, they make adjustments in their software for their cash expenditures. You will make entries for income as you deposit them into your bank account which should be done as often as you find works for you.

One difficulty freelancers have is when they mix personal and business expenses. Too often people don't have a good sense of what is being spent for business and what is being spent for personal. They spend whatever they have for either business or personal, whichever is more pressing. One solution for this is to separate out your accounts. If you have separate business and personal accounts, you can see your yearly business income after business expenses. You can then calculate a workable amount that you will be able to withdraw from your business account on an ongoing basis for your personal needs.

"I have enough money but it hasn't been paid me yet." People often overlook that money is not in your pocket until you collect it. Too often freelancers do not try to collect their receivables. They worry that they may offend their clients or assume that they will be paid eventually. You should set up a monthly billing system where every client who owes you money gets billed. After two or more unpaid bills, you might call to discuss the unpaid amount. If an ongoing client has a history of not paying in a reasonable time, collect part of the fee up front on the next job if you can. If the client continues not to pay, perhaps the client is not going to pay and is not worth having.

People are often so busy trying to pay their bills that they don't step back to see if they have a viable business plan, if they have been marketing their business enough, or if they have a viable business in the first place. The key is that you are in business. You are not working for someone else whose responsibility it is to meet your payroll. Every business should have a business plan which should be revisited on a periodic basis.

Tracking how you spend your money and finding out your cash flow can lead you to an understanding of how your business is going which you will find very rewarding.

Susan Lee, EA, CFP is a New York tax and financial planner who specializes in freelancers and who has often written for this newsletter. She hosts and produces YOU AND YOUR MONEY on Friday, 10:30 am on WBAI- fm (99.5) or on WBAI.org. She is available for your questions at [www.freelancetaxation.com](http://www.freelancetaxation.com) or 212 633 1516

### Budget Worksheet

Monthly Expense Items	Now	Projected	Adjusted spending
Rent			
Food and household incidentals			
Utilities, telephone, cell			
Local transportation			
Auto operating/maintenance			
Clothing and personal items			
Property improvements/upkeep			
Property taxes			
Child care			
Alimony, child support			
Entertainment			
Vacations			
Books, papers, subscriptions			
Internet			
Home furnishings			
Gifts			
Medical expenses			
Other expenses			
Mortgage payment			
Student loan payment			
Auto loan			
Credit card payments			
Other loan payments			
Life insurance premiums			
Medical ins premiums			
Auto ins premiums			
Homeowner/renters ins premiums			
Disability premiums			
Other insurance			
Income/self-employment/fica taxes			
Business expenses			
Savings			
Total			
Total multiplied by 12 = yearly costs			



## Financial check list

By Susan Lee, EA, CFP

Here are some basic questions to ask yourself about your financial life:

- 1) Do you have an adequate emergency fund?
- 2) Are you satisfied with how you spend your money?
- 3) Have you thought about your top three financial goals and planned how you're going to achieve them?
- 4) Are you funding a retirement plan?
- 5) Are you saving what you feel you should be, and is this amount enough to achieve your goals?
- 6) Have you recently analyzed the money that you have invested recently to see that it's invested and allocated in the ways you want and need?
- 7) Do you have sufficient protection against the risks of living and doing business (medical, life, disability, homeowners/renters and business owners insurance)?
- 8) Is your career satisfying you financially and in other ways that are important to you?
- 9) Do you have an up-to-date will?
- 10) Are you current with your tax filings and payments?
- 11) If you're in debt, are you paying it off or incurring more?
- 12) Do you have a plan that will allow you to live as you wish to live?

Susan Lee, EA, CFP is a tax and financial planner. You can call her with questions at (212) 633 1516 or email her at [www.freelancetaxation.com](http://www.freelancetaxation.com)

## Common Freelance Mistakes

By Susan Lee, EA, CFP

Some mistakes that too many freelancers make

- Believing you earn too little to file taxes. You have to pay self-employment tax if you have a profit of \$400 or more.
- Thinking and spending like your gross income is your personal income. Your personal income is your gross income minus all your business expenses.
- "If I don't get a 1099, I don't have to declare the money." Whatever you get paid must be declared. A related misperception is that if you get paid in cash, it doesn't count. It is your responsibility to keep track of every dollar you earn and to report it.
- An extension is an extension to pay. With this way of thinking, you only owe the money by October 15<sup>th</sup>. You must pay what you owe when you file the extension or you will be charged extra. And if you haven't paid in enough withholding or estimated taxes over the previous year, you may be charged for that as well.
- A credit card statement serves as sufficient proof at an audit that you bought something. This belief is partially right. A credit card statement serves as proof that you purchased something from that vendor. You need a receipt saying exactly what you bought as well as the credit card statement or the check. If you pay cash, you generally need a receipt as well.
- If you have money paid in for estimated taxes and withholding and you don't think you owe anything, you do not have to file a return. You must still file a complete tax return. A related misperception is that if you haven't filed and are due a refund, that you can always file and get that money. You only have three years to get a refund.
- You can put whatever name you want for you, your spouse, or your children on your tax return. The IRS will not let you take an exemption if the name doesn't match the name on that person's Social Security card.
- The income you put on your schedule C is the amount you've billed. Typically, you're on the cash basis. You should put in the amount of money you've received in the calendar year for which you're filing.
- If someone owes you money, you can always send them a bill. While technically true, the longer you put off billing a client, the longer it takes to collect what you are owed, and you might not be able to collect it at all.
- You rely on the 1099's you receive and declare that income. If you don't keep track of the money you receive, you can't tell if the 1099's are accurate nor can you correct any errors. You won't be able to tell if you missed getting a 1099. The IRS will then send you a letter saying you owe additional money plus penalties and interest. Then you will have to settle with the state(s) you live and/or work in.
- You don't believe that you really have to keep good records or that you will ever get audited. Unfortunately when the letter comes from the IRS telling you that your

business income and expenses will be reviewed in detail and you realize that the failure to have records means that unless you go through a lot of hassle which might not be enough to help the situation, you might owe a lot of money, and it's too late, at least for that year.

- You incorporate your business because you think all businesses should be incorporated. You heard incorporating would save you money. Then you discover that you have to be on a W-2 as the owner, that you have to be much more rigorous about the accounting system you use, that you have to file separate forms as a corporation and that the whole thing is more expensive and more of a headache than not being incorporated. When you have a business, investigate what form your business should take. You might decide that being a sole proprietor remains the simplest and best for you. You can also look into being a single member llc instead of a corporation. For some of you, a corporation might be the option you choose.
- You ignore reimbursed expenses. The IRS says you owe additional taxes. They expect you to include reimbursed expenses as income and deduct the expenses appropriately on your schedule C.



## Preparing to Do Your Taxes: Remembering Your Income

By Susan Lee, EA, CFP

How can I organize my papers so I don't leave any income out when I do my taxes? The most systematic way is to take a copy of last year's taxes or the organizer your tax preparer sends you and match item by item. If you do it this way and discover you have not received a 1099 from a bank or other payer that gave you income last year, you will be reminded that you should call the bank or other payer and ask about it if it has not come by the end of January. Otherwise it might slip through the cracks.

Freelancers sometimes mix W-2 items into their freelance income on their Schedule C or sole proprietorship form. Then when the IRS sends a correction saying that they left out the W-2 income, they have to see what exactly they did that year to figure out if the IRS is right. Wages that has taxes taken out goes on the wage line and must have a corresponding W-2 with it.

The IRS, by the way, is getting very good at matching W-2's and 1099's to income tax forms. Just because you might not have gotten a 1099 for something does not mean that the IRS did not. You are supposed to declare all the money you received whether or not you received a 1099 for it. (The person who contracted you for the freelance job does not have to send you a 1099 if the amount was under \$600.) Understand that people file their 1099's late; you may not have received your 1099 by the time you file your taxes. That doesn't mean that the IRS won't receive the 1099 sooner or later and then match it to you.

Keep track of every payment every person sent you during the year. Then match that amount to the 1099 that you received to make sure that the amount is the same. If it's not, call the people who issued the 1099 and discuss the discrepancy. 1099's can be changed. If you have a record of the payments made to you, figuring out your income for tax purposes becomes comparatively easy.

It's a good thing to put every tax document be it a 1099 or W-2 into one tax file as well as planning ahead by filing every stub or record of receiving money during the year. That way, the odd payment won't elude you.

Don't overlook unusual events that have tax consequences like:

- Unemployment payments
- Pension distributions
- State tax refunds
- Marriages or divorces
- Disability or sickness benefits
- Property or stock sales
- Starting a business

- Moving your business &/or your residence

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## What Papers Do I Need to Do My Taxes? By Susan Lee

This list of papers for your income and expenses will provide a good basis for what you need to do your taxes. Due to individual circumstances, you may have others you need as well.

### Income:

- 1) For freelance income, a record and total of all money received. This record can be a list of all checks, cash and credit card money received. You should have invoices for the money that was received. 1099's that you have received may not include all the money you received so don't just use the 1099's you've gotten.
- 2) Some people mistakenly believe that unless you have a 1099, you don't have to include the money in your gross receipts. All money received for work done must be included regardless of amount.
- 3) It is useful to compare your record of what you received from clients with what the 1099's say. If there is a difference in the amounts, you should resolve the difference before your taxes are filed.
- 4) W-2's for any wage income
- 5) 1099's and 1098's for interest, dividends, and pension distributions.
- 6) Names of any stocks or bonds sold, dates bought and sold, total paid for the property and total received.
- 7) If equipment or property used in business, name of equipment or property, dates bought and sold, total paid for the property and total received.

### Expenses:

- 1) You should have a receipt or a bill for every expense you take on your tax return. A credit card entry does not count as a receipt. Credit card statements indicate payment.
- 2) You should have a check or credit card entry for every receipt (except for those paid with cash).
- 3) Expenses should be totaled in the categories that you use on your tax return. On [www.freelancetaxation.com](http://www.freelancetaxation.com), please see a selection of lists for different professions.
- 4) You should have a date book for the year. This is useful to show appointment during the year that correlate to your travel and entertainment expenses as well as showing activities of your professional life.

- 5) There should be entries on your restaurant receipts for business entertainment for the date, the name of the restaurant, the cost, the name of the person you were with and the purpose of the meetings. For business meals costing less than \$75, you need the above information written in your date book.
- 6) You should keep a log of your total mileage for the year and for the business trips including mileage, location and purpose of the trip.
- 7) You should have the list of taxes paid for the previous year and the estimates paid for the tax year for which the return is being done. The list should be check by check with each having to whom written, a date, an amount, and the purpose. Your state may issue a 1099 for the previous year's taxable refund as well as what it calculates you have paid for state estimates; these records are useful to have.
- 8) You should have what you paid for health insurance, unreimbursed medical expenses, and medical transportation.
- 9) You should have 1099's for mortgage interest and real estate taxes.
- 10) You should have records for both cash and non-cash charitable contributions.
- 11) Child care expenses along with the child care provider name, address and employer identification number should be provided.



## **TAX DEDUCTIBLE EXPENSES FOR ARTISTS**

**This is a basic list of typical expenses of artists and designers. You may have others.**

**Studio rent**

**Art supplies**

**Telephone/Internet**

**Cabs, subways, buses**

**Book, magazines, reference material**

**Copying, printing**

**Office supplies**

**Promotion**

**Film & processing**

**Gas and electric**

**Memberships (museums, professional organizations)**

**Messengers, private mail carriers, postage**

**Hanging fees, entry fees, framing**

**Business insurance**

**Tax preparation, legal fees**

**Travel**

**Business meals and entertainment**

**Business gifts**

**Equipment and software**

**Cultural events/ museum entrance fees**

**SCHEDULE C**  
**(Form 1040)**

**Profit or Loss From Business**  
**(Sole Proprietorship)**

OMB No. 1545-0074

**2009**

Attachment  
Sequence No. **09**

Department of the Treasury  
Internal Revenue Service (99)

► **Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B.**  
► **Attach to Form 1040, 1040NR, or 1041.** ► **See Instructions for Schedule C (Form 1040).**

Name of proprietor		Social security number (SSN)
<b>A</b> Principal business or profession, including product or service (see instructions)	<b>B</b> Enter code from instructions	
<b>C</b> Business name. If no separate business name, leave blank.	<b>D</b> Employer ID number (EIN), if any	
<b>E</b> Business address (including suite or room no.) ► City, town or post office, state, and ZIP code		
<b>F</b> Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ►		
<b>G</b> Did you 'materially participate' in the operation of this business during 2009? If 'No,' see instructions for limit on losses. <input type="checkbox"/> Yes <input type="checkbox"/> No		
<b>H</b> If you started or acquired this business during 2009, check here		

<b>Part I</b> <b>Income</b>	
1 Gross receipts or sales. <b>Caution.</b> See the instructions and check the box if: • This income was reported to you on Form W-2 and the 'Statutory employee' box on that form was checked, or • You are a member of a qualified joint venture reporting only rental real estate income not subject to self-employment tax. Also see instructions for limit on losses. <input type="checkbox"/>	1
2 Returns and allowances	2
3 Subtract line 2 from line 1	3
4 Cost of goods sold (from line 42 on page 2)	4
5 <b>Gross profit.</b> Subtract line 4 from line 3	5
6 Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6
7 <b>Gross income.</b> Add lines 5 and 6	7

<b>Part II</b> <b>Expenses.</b> Enter expenses for business use of your home <b>only</b> on line 30.			
8 Advertising	8	18 Office expense	18
9 Car and truck expenses (see instructions)	9	19 Pension and profit-sharing plans	19
10 Commissions and fees	10	20 Rent or lease (see instructions):	
11 Contract labor (see instructions)	11	a Vehicles, machinery, and equipment	20 a
12 Depletion	12	b Other business property	20 b
13 Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13	21 Repairs and maintenance	21
14 Employee benefit programs (other than on line 19)	14	22 Supplies (not included in Part III)	22
15 Insurance (other than health)	15	23 Taxes and licenses	23
16 Interest:		24 Travel, meals, and entertainment:	
a Mortgage (paid to banks, etc.)	16 a	a Travel	24 a
b Other	16 b	b Deductible meals and entertainment (see instructions)	24 b
17 Legal & professional services	17	25 Utilities	25
28 <b>Total expenses</b> before expenses for business use of home. Add lines 8 through 27	28	26 Wages (less employment credits)	26
29 Tentative profit or (loss). Subtract line 28 from line 7	29	27 Other expenses (from line 48 on page 2)	27
30 Expenses for business use of your home. Attach <b>Form 8829</b>	30		
31 <b>Net profit or (loss).</b> Subtract line 30 from line 29. • If a profit, enter on both <b>Form 1040, line 12,</b> and <b>Schedule SE, line 2</b> or on <b>Form 1040NR, line 13</b> (if you checked the box on line 1, see instructions). Estates and trusts, enter on <b>Form 1041, line 3.</b> • If a loss, you <b>must</b> go to line 32.	31		
32 If you have a loss, check the box that describes your investment in this activity (see instructions). • If you checked 32a, enter the loss on both <b>Form 1040, line 12,</b> and <b>Schedule SE, line 2,</b> or on <b>Form 1040NR, line 13</b> (if you checked the box on line 1, see the line 31 instructions). Estates and trusts, enter on <b>Form 1041, line 3.</b> • If you checked 32b, you <b>must</b> attach <b>Form 6198.</b> Your loss may be limited.		32 a <input type="checkbox"/> All investment is at risk.	
		32 b <input type="checkbox"/> Some investment is not at risk.	



**SCHEDULE SE**  
**(Form 1040)**

**Self-Employment Tax**

OMB No. 1545-0074

**2009**

Attachment  
Sequence No. **17**

Department of the Treasury  
Internal Revenue Service

▶ **Attach to Form 1040.** ▶ **See Instructions for Schedule SE (Form 1040).**

Name of person with self-employment income (as shown on Form 1040)

Social security number of person  
with self-employment income ▶

**Who Must File Schedule SE**

You must file Schedule SE if:

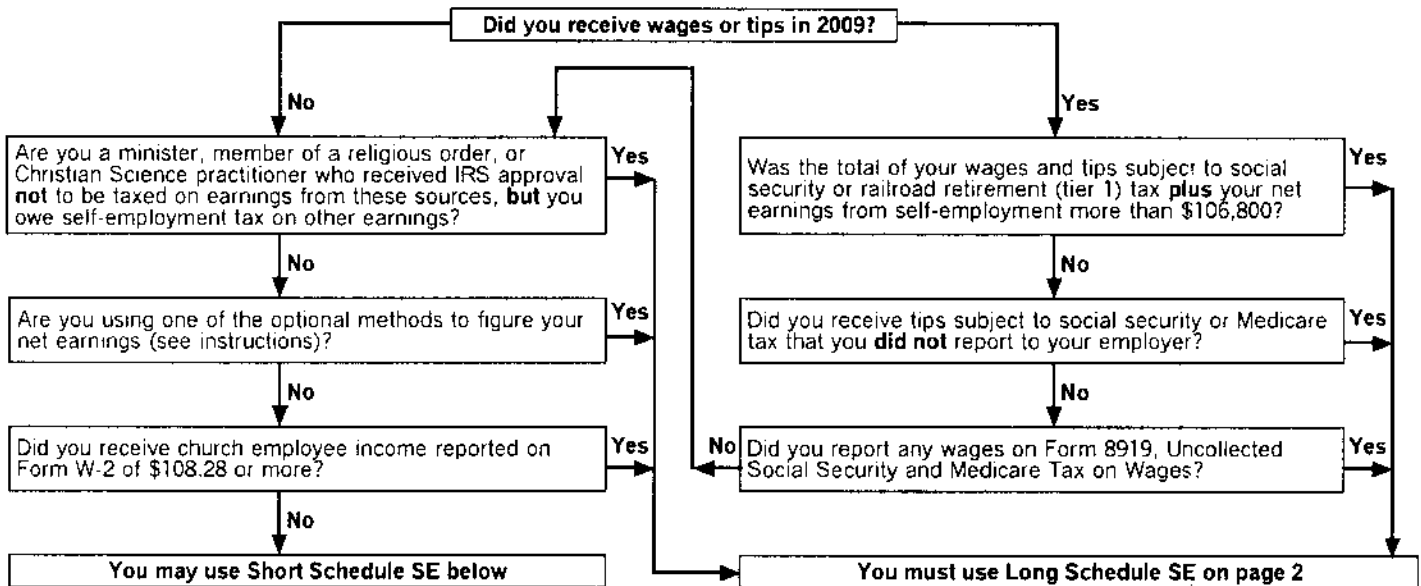
- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of **\$400 or more, or**
- You had church employee income of **\$108.28 or more**. Income from services you performed as a minister or a member of a religious order **is not** church employee income (see instructions).

**Note.** Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either 'optional method' in Part II of Long Schedule SE (see instructions).

**Exception.** If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write 'Exempt - Form 4361' on Form 1040, line 56.

**May I Use Short Schedule SE or Must I Use Long Schedule SE?**

**Note.** Use this flowchart **only** if you must file Schedule SE. If unsure, see *Who Must File Schedule SE*, above.



**Section A -- Short Schedule SE. Caution.** Read above to see if you can use Short Schedule SE.

1 a Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A	1 a	
b If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 6b, or listed on Schedule K-1 (Form 1065), box 20, code Y	1 b	
2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instrs for types of income to report on this line. See instrs for other income to report	2	
3 Combine lns 1a, 1b & 2	3	
4 <b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, <b>do not</b> file this schedule; you do not owe self-employment tax	4	
5 <b>Self-employment tax.</b> If the amount on line 4 is: • \$106,800 or less, multiply line 4 by 15.3% (.153). Enter the result here and on <b>Form 1040, line 56.</b> • More than \$106,800, multiply line 4 by 2.9% (.029). Then, add \$13,243.20 to the result. Enter the total here and on <b>Form 1040, line 56.</b>	5	
6 <b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on <b>Form 1040, line 27.</b>	6	



How to Prepare for an Audit  
By Susan Lee, EA, CFP

If you're being audited for your freelance business, this article will give you the basic information that you will need for your audit. There may be other issues that will be covered in your audit as well.

If you're not being audited for your freelance business, this article will give you a preview of what you will need should an audit letter come to you and will allow you to prepare your taxes and keep your records so that an audit letter will not mean an inordinate time spent preparing for your audit.

The first you will hear about an audit is in a letter from the IRS or whatever state or local taxing authority you file with. This article will only deal with the IRS and audits for freelance income.

Regard this IRS letter as your instruction sheet that you must adhere to as closely as possible in order to have a successful audit. It is important you read every line and regard each request as something you must fulfill to your utmost. The letters vary about what the agent will deal with at the audit.

You may or may not be asked about each thing you've prepared for the audit. Because you don't know what will be addressed, each item must be prepared as thoroughly as possible. My sense is that you or your representative will be judged on the first one or two items asked. If your receipts or income match what is on the tax return, the rest of the audit may go a bit easier.

A successful audit will be different for different people. For some, it's one where the person finishes the audit in a short period of time and is told they have a "no change" which means they don't owe anything. For others if what they owe is less than they feared, they have succeeded.. And for still others, it's getting back money.

Preparing for an audit is more or less arduous depending on how the person has prepared their taxes and kept their records.

Some people are so angry at being audited that they go into the IRS with their negative feelings. While I understand these feelings of anger, I don't believe it does you any good to bring anger to the audit. For most agents I have dealt with, a calm, respectful, businesslike demeanor works better along with thorough preparation. Another attitude is one of "I'm an artist, I shouldn't have to go through this" also doesn't work very well. You have presented yourself to the IRS as a business. The IRS expects you to have all your receipts, records and invoices regardless of what business you're in.

I do find it helpful to bring in a resume and samples of the artist's work reprinted in books and magazines to give the agent a sense of what you do. This is especially true for those people who have taken losses in their businesses and have to show that they are indeed in the business they have said they are in.

An appointment must be set. The IRS letter will give you the name of the agent and his or her phone number to call to make an appointment. Before you call, see what is being requested and how well you are prepared so you can set a date that is reasonable for you or your representative to go and present your materials in a complete way. The letter will tell you what year is under audit and what information is being asked for.

Typically, you will be asked for copies of the year under audit, the year before and the year after. You will not initially need to bring anything but these copies for the year before or after but the IRS holds open the right to open up those years should the IRS agent so choose.

You could be asked for copies of all your bank statements, your brokerage statements and your credit card statements for the December before the year being audited, the year being audited, and the January after the year being audited. These are useful to the agent for two major reasons: to check the amounts of money deposited into your accounts and to verify expenses that you've claimed.

You could be asked for logs and notes that you used to prepare your taxes. A datebook for the year under audit is useful to bring. Make sure that any travel that you deducted is reflected in the datebook as well as corresponding business meals. In other words, if you deducted a trip to San Francisco for a conference and your datebook only has local entries, an agent might regard the trip with suspicion.

You could be asked for invoices, 1099's and other ways you used to determine your income. Add up the invoices again and attach a tape of the numbers to the clipped invoices to show the agent. Add up all the deposits into your various accounts. If there is a difference, determine the cause of the difference. If you received outside gifts, you might bring a letter from the people giving you the gifts so that it is clear that this money is not income. There may be a difference between what you received from 1099 clients and what was deposited. You may

have a check that was received in the following year although it was included on the 1099 for the year being audited. Show the agent how the difference was deposited the year after because it was received in that year. Also if you have shared accounts, sometimes spouses write each other checks that the IRS thinks is income. Bring a list of these and copies of the checks to show that these checks weren't income but simply intrafamily transfers.

The IRS will ask for proof of different expenses. The bottom line is that you should have proof of purchase and proof of payment. This means that there is a receipt and either a check or a copy of the credit card statement you put it on. A credit card statement by itself is not enough. You have to show what was bought with that payment. There may be some small things that are paid with cash for which you have a receipt and that's fine. There may be some things that you do not have proof for as with certain taxi rides or magazines. In this case, the expenses should be listed in your datebook or on a separate page and it is up to the discretion of the agent about whether or not to accept the expense.

Getting copies of the checks is the way to show proof of payment on a checking statement unless the statement shows to whom the check is made. This is why having paper checks is advantageous. And why you should keep copies of your checks and those photocopies of the checks that are sent out.

I personally attach a copy of each check or each credit card payment to the receipt in each category. This means that the agent doesn't have to rifle through your checking and or credit card statements to find a single payment. I am then able to hand over each category of receipts and invoices along with a tape total which hopefully match what is on the Schedule C.

Each category of expense that is requested should be presented separately, in chronological order if possible. A tape of the expenses with the total could be attached to show that it matches the number given on the tax return.

Too many people expect the IRS agent to plow through piles of receipts, organize them and come up with a result that is one that the taxpayer will like. While this is possible, I wouldn't encourage it. My method is to be as thorough as possible, in order to take as little time of the agent as possible. Also, my experience is that the more methodically and completely prepared the material is put together, the more chance that the agent will be flexible about an item here or there that might be missing and the better the result.

For specifics regarding different expense areas, go to [www.irs.gov](http://www.irs.gov).

- For travel, car and meal expenses, go to Publication 463.
- For home office issues, go to Publication 587.
- For general business expenses, go to Publication 535.

When should you use a professional to help you with your audit? While I am confident that there are some people who do not need to consult a professional to get through this process, I believe that most people would benefit from either having a tax preparation professional who has experience with audits either represent them at the audit or help them prepare for the audit.. In situations where records are not complete, where losses have been taken for more than two out of the past five years, where income has been underreported, or where you are not confident of what's on your tax return or your audit preparation, consultation or representation might be a good idea.



## How Long Do I Have To Keep Those Papers?

By Susan Lee, EA, CFP

The ground rules: You should keep all your tax records for at least the three years the IRS has to audit you and assess any additional taxes. The IRS has six years if you understated your gross income by more than 25%. There is no statute of limitations if you failed to file a return or filed fraudulent returns.

Tax returns and supporting documents: At the minimum, keep them three years. I like keeping the tax returns but not the supporting documents forever for the very rare times a governmental agency sends a notice out saying you haven't filed a tax return you in fact filed years ago.

Yearly income: Keep your last pay stub to see if your W-2 accurately reflects your income. Keep a record of every check you receive, especially the unusual ones that you're more likely to forget. Record what comes in be it free lance or wage income, dividends and interest, rents, alimony, social security, unemployment or gifts and check it against your W-2's, 1099's and K-1's.

Yearly expenses: You need to know how much you spent for deductible items like charitable contributions, mortgage interest, real estate taxes, medical expenses, alimony, child care expenses, and business/ job expenses. Keep sales slips, invoices, receipts, and cancelled checks or other proof of payment. The more records you keep, the more likely you'll be able to be accurate on your tax returns

Investments: Whether it's real estate or stocks and bonds, you should keep all the information about how much the property cost you and when you bought it and any additional purchases and dates. This means keeping all those stock purchase slips. If you own mutual funds and reinvest dividends and capital gains, keep the original purchase slips plus each year's 1099's in a mutual fund file so you can figure out the proper costs when you go to sell them. Brokerage and bank statements are invaluable when you go back to find something out. If you own real property, keep your closing papers and proofs of payment as well as records of any improvements for as long as you own the property. If you sold a home before 1998, keep form 2119 until you've sold the replacement home. It is useful to keep these copies in separate files labeled "home" or "mutual funds" rather than in a yearly overall tax file. Keep all buy and sell records for at least three years after the transactions are completed.

Permanent files: Birth certificates, social security numbers, educational degrees, marriage licenses, divorce agreements, professional licenses, passports, wills, and copies of estate and gift tax returns should be kept permanently in a separate file. Sooner or later, you will need access to one of these documents. It makes life easier to know where it is.

Susan Lee, EA, CFP is a tax and financial planner. She is available for your questions at 212 633 1516 or [www.freelancetaxation.com](http://www.freelancetaxation.com).



Useful Financial and Tax Books  
By Susan Lee, EA, CFP

Did you ever want to read about financial or tax issues but didn't know where to begin? Here are some books that you might find helpful.

Money is about spending, saving and investing. Here are some basic financial guides:

**7 MONEY MANTRAS FOR A RICHER LIFE** by Michelle Singletary. Many money books promise you painless fantasy wealth. Michelle Singletary's aim is to help you live well with the money you have.

**PERSONAL FINANCE FOR DUMMIES** By Eric Tyson. This is the first of Eric Tyson's very readable books that will give you an overview to your financial life. If you like this one, you can go on to his **INVESTING FOR DUMMIES** and **MUTUAL FUNDS FOR DUMMIES**

**THE RANDOM WALK GUIDE TO INVESTING** by Burton Malkiel. Conciseness is the key. Burton Malkiel gives ten useful and accessible rules for financial success.

Money is about how you live your life and how you approach the very subject of money itself

**YOUR MONEY OR YOUR LIFE** by Joe Dominguez and Vicki Robin. Isn't there more to life than just earning money? This book will help you think about the relationship of money to how you want to live your life.

**THE SEVEN STAGES OF MONEY MATURITY** by George Kinder. This author is one of the founders of the life planning movement which sees financial planning as more than about dollars and cents. The book aims to help you understand the spirit and value of money in your life.

Two basic tax guides, one free, one not, are:

**YOUR FEDERAL INCOME TAX For Individuals:** The Internal Revenue Service annually updates Publication 17 to answer questions on taxation for individual taxpayers. You can call 1 800 829 3676 or go to your local IRS and get a copy of Publication 17 for free.

**JK LASSER'S YOUR INCOME TAX:** When you go into your bookstore around tax time to look for a tax guide, you'll see piles of different popular tax books. Many of them are good. I have found this the one I like best for answers to many basic tax issues.

Susan Lee, EA, CFP is a tax and financial planner.. She hosts and produces **YOU AND YOUR MONEY** on Friday, 10:30 am on WBAI- fm (99.5) or on WBAI.org. She is available for your questions at [www.freelancetaxation.com](http://www.freelancetaxation.com) or 212 633 1516



Useful Tax and Financial Websites  
By Susan Lee, EA, CFP

Ever have a question about tax or financial issues that you wanted an answer to? Here are some sites that you might find helpful to find those answers.

[www.irs.gov](http://www.irs.gov): If you have a question for the IRS or need a form for this year or a former year, you can go the IRS site for answers to frequently asked questions, publications that are comparatively easy to read and forms that may be looked at on-line or downloaded. You can also figure your withholding allowances using its W-4 calculator. States also have websites. New York's is [www.tax.state.ny.us](http://www.tax.state.ny.us).

[www.bigcharts.com](http://www.bigcharts.com). If you need to know the quote for a stock or mutual fund in the past as well as currently, you can find it here.

There are many useful financial sites on the web, often part of a magazine, television channel, or financial business like mutual fund. [www.smartmoney.com](http://www.smartmoney.com), [www.kiplinger.com](http://www.kiplinger.com), and [www.msn.com](http://www.msn.com), all have financial information and arrays of financial tools that you can take advantage of. Mutual fund companies not only have information on their mutual funds (eg [www.vanguard.com](http://www.vanguard.com)) but often also have financial tools that you can use.

You can do basic retirement planning and college planning on many of the general sites. When you want more specialized information on college planning, for instance, you can go to [www.savingforcollege.com](http://www.savingforcollege.com).

[www.morningstar.com](http://www.morningstar.com) has up-to-date information on mutual funds and stocks. You can get an in depth analysis of each fund and stock you own as well as asset allocation tools.

The trick is not to become overloaded. Also don't be sidetracked by the proprietary offerings on whatever site you're on. If you for instance want debt reduction information, you can go to [www.quicken.com](http://www.quicken.com) which has a lot of general information on it and which also has a debt reduction tool on it that may you find informative.

For mortgage information, go to [www.hsh.com](http://www.hsh.com) to figure out how much mortgage you qualify for as well, how much you can afford, is it worth it to refinance as well as how much will a particular loan cost per month.

Be aware that each financial tool is based on assumptions. The tool is only as good as the assumptions you put into it. For instance, if you say that you will get an 8% return on your money until you retire and you only get 4%, your calculations will be off.

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Small Business Financial Disaster Kit  
By Susan Lee, EA, CFP

Vital financial records should be kept. Copies of the following documents should be available for taking with you if you have to leave your home in an emergency. You could scan these documents into your computer and take a disc or flash drive instead of paper copies. Also have the telephone numbers and email addresses of anyone you might have to contact e.g. clients, vendors, financial advisors, insurance companies, banks, and credit card companies.

Consider having a week's supply of cash and a roll of quarters as well as instructions to your loved ones to help them handle your business affairs if you are not there.

- Client and vendor lists with contact information
- Employee information; up-to-date payroll records
- Credit cards
- Powers of attorney
- Property deeds and mortgage papers
- Recent bank and brokerage statements and stock and bond certificates
- Car titles and registrations
- Insurance policies (liability, health, disability, auto, business owners, errors and omission, renters)
- Company benefits
- List (or pictures) of valuables and their worth as well as a list (or pictures) of other possessions
- Recent income tax returns
- Recent checking account records and checks
- Backups of digital information and software
- Backups of client and vendor contracts and important file information
- Copies of business plans and operation schedules and methods
- Copies of inventory of goods and supplies
- Will with instructions for dealing with your business affairs.

Susan Lee, EA, CFP is a tax and financial planner. She hosts and produces **YOU AND YOUR MONEY** on WBAI-fm (99.5) in New York and on [www.WBAI.org](http://www.WBAI.org). She can be contacted at [www.freelancetaxation.com](http://www.freelancetaxation.com).



## Personal Financial Disaster Kit

By Susan Lee, EA, CFP

Vital financial records should be kept in a safe place in normal conditions. Copies of the following documents should be available for taking with you if you have to leave your home in an emergency. If possible, keep paper copies in a water and fireproof container. You could scan these documents into your computer and take a disc or flash drive instead of paper copies. Also have the telephone numbers and email addresses of anyone you might have to contact e.g. family members, friends, financial advisors, insurance companies, and credit card companies.

Consider having a week's supply of cash and a roll of quarters as well as instructions to your loved ones to help them if you are not there.

- Birth, marriage, and death certificates
- Divorce and child custody papers
- Social Security cards
- Drivers licenses
- Credit cards
- Adoption papers
- Passports
- Wills, living wills, and health care proxies
- Powers of attorney
- Property deeds and mortgage papers
- Recent bank and brokerage statements and stock and bond certificates
- Car titles and registrations
- Insurance policies (life, health, disability, long term care, auto, homeowners, renters)
- Military records
- Company benefits and recent pay stubs
- List (or pictures) of valuables and their worth as well as a list (or pictures) of other possessions
- Recent income tax returns
- Recent checking account records and checks
- Online passwords and toll free numbers
- Copies of education degrees and licenses

- Backups of digital information
- Medical and dental records and prescriptions

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10 Tips on Preventing Identity Theft  
by Susan Lee, EA, CFP

Identity theft is not something you want to have happen to you. Getting out from under the problems caused by identity theft can take months and, sometimes, years. Here are 10 tips that will go a long way to stopping you from becoming an identity theft victim.

- 1) Put all discarded mail and forms with your personal information on it through a shredder. Use a crosscut shredder if possible. Whatever is in your mailbox or trash can be stolen and used as the basis for opening an account in your name.
- 2) Check your credit record annually with each of the three major credit agencies: Equifax (800 865 1111), Experian (888 397 3742), and Transunion (800 888 4213). You may discover transactions on your reports that you had nothing to do with. To be more proactive, you can sign up with an online service that will email you any time any entry is made on your credit report. This way you will not discover that someone has taken out a mortgage in your name ten months after it has occurred.
- 3) Never respond to an online query by giving your personal information. There are many attempts now to get this information by saying, for example, that you are preapproved for a mortgage application. This new wave of scamming is called "phishing". If you respond to it or click a link in it, you will be the phish caught on the hook. Delete such queries. There is no need to give anyone online any personal information unless you have initiated the transaction.
- 4) If you use online banking and credit card services, make it a habit to check that your entries and your balances are what they should be.
- 5) Your Social Security number (SSN) is yours. Keep it private for as long as you can. Do not give it out unless you absolutely must. For example, a prospective employer needn't know the number until after you've been hired. Do not carry your Social Security card or number with you.
- 6) Tell the three major credit reporting agencies to block promotional disclosure of information about you. This reduces the number of pre-approved credit cards that will come to you. The credit reporting opt-out call number is 888 567 8688.
- 7) Do not use checks with your driver's license number, social security number, or telephone number on them.
- 8) If you are not getting mail that you routinely get, like monthly bills or bank statements, check with your post office to see if a change of address form has been filed in your name.
- 9) Use a password on your credit card, bank, utility and phone accounts if possible. Using your mother's maiden name, your birth date, your SSN's last four digits, your phone number or consecutive digits are too easy for others to use.
- 10) Make sure your computer is as protected as you can make it. Update virus protection software. You wouldn't invite someone into your home you don't know; be as leery of links. Keep a firewall on at all times. Before you get rid of a computer, use software that clears your computer of all the information on it.