

CULPEPPER & ASSOCIATES

DISCLOSURE & ACKNOWLEDGMENT REGARDING BUSINESS EXPENSES

Dear Client,

This disclosure is provided for you in order to clarify what business expenses may be taken in general on the following IRS forms:

- 1120 & 1120S Corporate Tax Returns
- 1065 Partnership (LLC) Tax Returns
- Form 2106 of 1040 Individual Tax Returns
- Statement SBE (Supplemental Business Expenses) on Schedule E of 1040 Individual Tax Returns

Business Expenses – General Overview

To be deductible, a business expense must be both ordinary and necessary. An expense does not need to be indispensable to be considered necessary. An expense must also not be a personal expense (unrelated to the business). If you have expenses that relate to both personal and business, you must make an allocation and be prepared to support the allocation under IRS audit.

Ordinary = common and accepted in the industry

Necessary = helpful and appropriate to your business

Business expenses may include:

- Advertising
- Automobile
- Wages
- Meals & Entertainment
- Travel
- Equipment & Depreciation
- Interest
- Rent or Home Office
- Continuing Education
- Professional Consultations
- Insurance
- Business Licensing
- Taxes
- Pensions & Retirement Plans

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Generally, in the event of an audit, you will be required to provide written support for all expenses listed.

Record-Keeping and Transactions

In order to assist with record-keeping and IRS compliance, we recommend that businesses have their own bank accounts and that all business-related transactions be run through said accounts. We also recommend that there be no commingling of funds (in other words, don't pay for personal items with the business bank account). This helps to establish that the business is being run like a business, again in the event of an IRS audit, in order to minimize disallowed expenses.

Auto Expenses

You may deduct automobile expenses under either one of two methods:

- Standard mileage rate (48.5 cents for 2007 and 50.5 cents for 2008, etc.)
- Actual expenses (you must have documents such as receipts, etc.)

If you use the automobile for both personal and business use, you must adequately track mileage so that we can allocate the actual expenses between personal and business. Whatever method you use for auto expense, you must keep a mileage log which you can get at any office supply store. There must be a separate log in each automobile for which you are taking business expenses.

If you use a company-owned automobile for personal use, you may also have to include the fringe benefit of using that vehicle, on your personal 1040 Tax Return.

Meals & Entertainment

Meals and Entertainment expenses are generally deductible as long as they meet either of two tests.

Directly-Related Test

1. The main purpose of the combined business and entertainment was the active conduct of business
2. You did engage in business with some person or persons
3. You had more than a general expectation of getting income or some benefit in the future

Associated Test

1. Associated with the active conduct of your trade or business
2. Directly before or after a substantial business discussion

The IRS generally determines whether the above tests have been met, as based upon a "facts and circumstances" test. Thus each situation must stand on its own merits. For this reason, it is important to fully document expenditures. An easy way to do this is to write on the receipt and/or the bank statement or credit card statement.

Documentation Requirements

1. Business purpose
2. Parties present

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3. Name and address of venue

Travel

Travel expenses are the ordinary and necessary expenses of traveling away from home for your business, profession or job.

You are traveling away from home if:

1. Your duties require you to be away from home longer than an ordinary day's work
2. You need to sleep or rest to meet the demands of your work while away from home

You merely need to document the business purpose for traveling expenses.

Home Office

You may be able to deduct the business use of your home if the following apply:

- Use part of your home exclusively and regularly as your principal place of business
- Use part of your home exclusively and regularly as a place where you meet customers or conduct business
- Your business use must be for the convenience of your employer (Form 2106)
- Your business use must be for the convenience of the Partnership or S-Corp (Statement SBE)

In order to satisfy the IRS requirements, you will need to provide us with information of your home as follows:

1. Total square footage of the residence
2. Square footage of the area being used for business purposes
3. All deductible expenses that relate your home as a whole (rent, electricity, etc.)
4. All deductible business specific expenses (cellular phone, etc.)
5. Time your were open for business (in the case of a daycare)

Form 2106 of 1040 Individual Tax Returns

Unreimbursed Expenses incurred by an employee on behalf a business, are generally deductible. However, recently the Tax Court disallowed unreimbursed business expenses of an employee due to lack of a formal agreement between the business and the employee. Thus we recommend that all partners have an agreement which states that the partner must incur expenses and that those expenses will not be reimbursed by the partnership.

Statement SBE (Supplemental Business Expenses) on Schedule E of 1040 Individual Tax Returns

Unreimbursed Expenses incurred by a partner in a partnership, are generally deductible. However, recently the Tax Court disallowed unreimbursed business expenses of a partner due to lack of a formal agreement between the partnership and the partner. Thus we recommend that all partners have an agreement which states that the partner must incur expenses and that those expenses will not be reimbursed by the partnership.

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Summary

We recommend you always run your business – like a business. Keep adequate records and make sure any licensing requirements are kept current. Keep a separate bank account from personal and don't commingle funds. Have a business plan. And above all – have fun and be profitable.

Acknowledgement

I attest the following:

- ✓ I have read the information contained within this disclosure.
- ✓ I have read page 26 of the IRS Publication 463 Travel, Entertainment, Gift, and Car Expenses and understand the IRS's position in regards what constitutes adequate records.
- ✓ I have read page 4 of the IRS Publication 587 Business Use of Your Home and understand the IRS's requirements for the Home Office deduction (if applicable).
- ✓ I understand that in the event of an IRS audit, investigation or request, I must be able to provide all supporting documentation for any expenses submitted by me and used by Culpepper & Associates for preparation of my tax return.
- ✓ I understand that I am ultimately responsible for the tax return and I hold harmless Culpepper & Associates, its affiliates and assigns in regards the preparation of my tax return.

Client/Business Name

Date

Client Signature

Client Title (if applicable)