Using Harvest to Track IRS Business Expenses

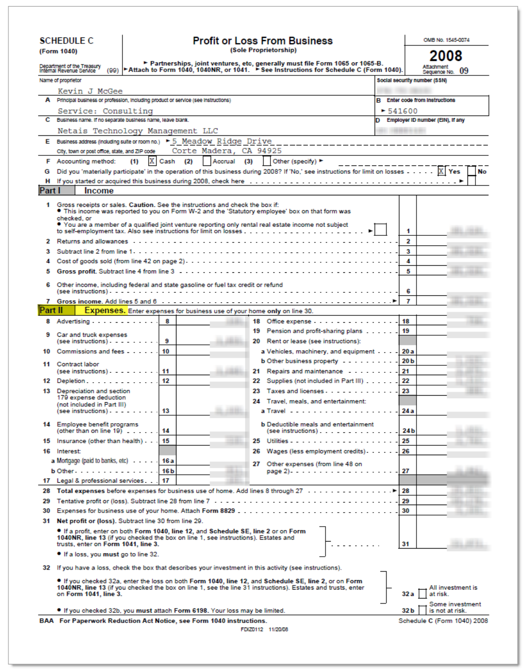
– Kevin McGee / NETAIS LLC, 3-August-2009

I don't know anyone who enjoys tax preparation. But after several years of running my own small professional services business, I've realized the exact cause for my irritation: tracking the expenses I rack up in a 12 month period. These amounts – all non-billable – find their way onto Schedule C of the U.S. Federal tax filing. Fortunately, Harvest makes recording and reporting them a breeze.

Disclaimer: this post shares techniques the author has found useful. It does not suggest a course of action, recommend any particular product, or claim to be best, or only way to perform expense tracking.

Start at the End

Like any writer, I approach a project by focusing on the final product. In this case, it's good old IRS *Schedule C - Part II Expenses*, to be exact.


SCHEDULE C (Form 1040)
Department of the Treasury Internal Revenue Service (99)
Profit or Loss From Business
(Sole Proprietorship)
► 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).
OMB No. 1545-0074
2008
Attachment Sequence No. 09

Name of proprietor: Kevin J McGee
Social security number (SSN)
A Principal business or profession, including product or service (see instructions): Service: Consulting
B Enter code from instructions ► 541600
C Business name. If no separate business name, leave blank. Netais Technology Management LLC
D Employer ID number (EIN), if any
E Business address (including suite or room no.) ► 5 Meadow Ridge Drive
City, town or post office, state, and ZIP code: Corte Madera, CA 94925
F Accounting method: (1) [X] Cash (2) [ ] Accrual (3) [ ] Other (specify) ►
G Did you 'materially participate' in the operation of this business during 2008? If 'No,' see instructions for limit on losses [X] Yes [ ] No
H If you started or acquired this business during 2008, check here ► [ ]

Part I Income

1 Gross receipts or sales. **Caution.** 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 ► [ ] 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 **Gross profit.** 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 **Gross income.** Add lines 5 and 6 ► 7

Part II Expenses. Enter expenses for business use of your home **only** 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):	
		a Vehicles, machinery, and equipment	20 a
11 Contract labor (see instructions)	11	b Other business property	20 b
12 Depletion	12	21 Repairs and maintenance	21
13 Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13	22 Supplies (not included in Part III)	22
		23 Taxes and licenses	23
		24 Travel, meals, and entertainment:	
		a Travel	24 a
14 Employee benefit programs (other than on line 19)	14	b Deductible meals and entertainment (see instructions)	24 b
15 Insurance (other than health)	15	25 Utilities	25
16 Interest:		26 Wages (less employment credits)	26
a Mortgage (paid to banks, etc)	16 a	27 Other expenses (from line 48 on page 2)	27
b Other	16 b		
17 Legal & professional services	17		

28 **Total expenses** before expenses for business use of home. Add lines 8 through 27 ► 28
29 Tentative profit or (loss). Subtract line 28 from line 7 29
30 Expenses for business use of your home. Attach **Form 8829** 30
31 **Net profit or (loss).** Subtract line 30 from line 29.
• If a profit, enter on both **Form 1040, line 12,** and **Schedule SE, line 2** or on **Form 1040NR, line 13** (if you checked the box on line 1, see instructions). Estates and trusts, enter on **Form 1041, line 3.**
• If a loss, you **must** 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 **Form 1040, line 12,** and **Schedule SE, line 2,** or on **Form 1040NR, line 13** (if you checked the box on line 1, see the line 31 instructions). Estates and trusts, enter on **Form 1041, line 3.**
• If you checked 32b, you **must** attach **Form 6198.** Your loss may be limited.
32 a [ ] All investment is at risk.
32 b [ ] Some investment is not at risk.
BAA For Paperwork Reduction Act Notice, see Form 1040 instructions. Schedule C (Form 1040) 2008
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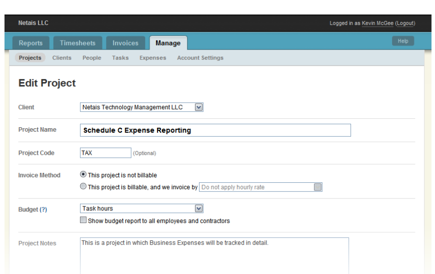
Part II contains a collection of common business expenses; the tax doc instructions defines them. I use these specific expense categories as the basis for record keeping throughout the year.

Setting Up Harvest

To begin, I use a client record that represents my firm. (This is useful for tracking a variety of things, not just expenses.)

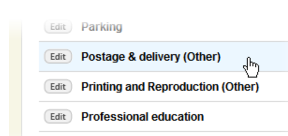
Next, I set up a project to serve as the "bucket" for all non-billable business expenses. Note that it's defined in Harvest as *non-billable*; this prevents data entry errors in the future.



Following that, it's time to get to work. Using *Manage* / *Expenses*, I set up an expense category for each expense line listed on Schedule C. Although this is pretty tedious, it's a one-time operation. (Maybe someday HARVEST will automate this step – hint, hint…)

It's worthwhile to note the simplicity of HARVEST expense categories – they are essentially tags. There's no facility to link expenses to accomplish "roll up" or so on. This is important only in situations where we want to track expenses in *more detail* than dictated by the Schedule C collection.

An example of this is the *Other Expenses* category. I prefer to track expenses for postage, printing, and other things separately, but report them all as



Other on Schedule C. For these expenses, I include in the name of the expense category a reminder of how to combine them for reporting at tax time.

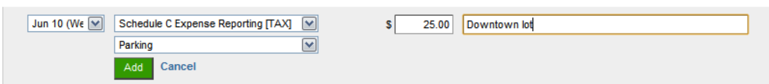
To quickly recap, I use a **Client** for my business, a **Project** dedicated for Tax, and a set of **Expense Categories** aligned to the Schedule C.

Record Keeping

My business expenses naturally group into three categories: one-off, credit card, and monthly recurring. Here's how I record them in HARVEST.

One Off

One-off expenses are occasional cash purchases. I save the receipt and enter it using the expense entry tool. Here's a sample entry for a parking structure that only accepted cash.



I mark the receipt so I know that it's been entered and stash it in a receipt folder. (Some folks go to trouble of scanning all receipts to go "paperless', but that's a *nice to have*. Just make sure you get and keep a receipt for all significant cash purchases. Your tax professional can define "significant" for you.)

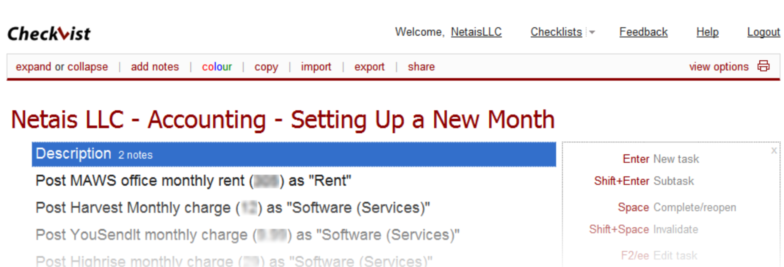
Credit Card

For credit card purchases, I use a separate card strictly for business purposes. When the statement comes, I work through it line-by-line and enter each purchase as an expense using HARVEST. This can be a little tedious, but I've found doing this once a month from the statement is the best tradeoff between time and effort. It also forces you to mentally "reprocess" each purchase which can be good for cost control. Don't forget to keep receipts for credit card purchases, too.

Monthly Recurring

As the business grows, there are more and more recurring expenses. Examples include rent, charges for technical services, and software subscriptions (like Harvest) that are billed monthly. Generally these charges have fixed amounts and due dates.

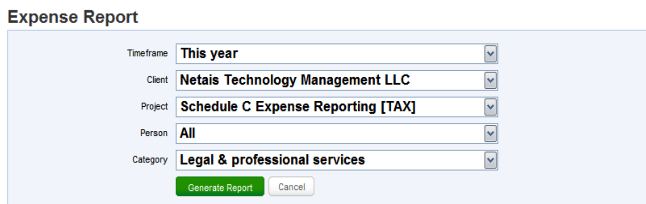
HARVEST could provide a little more help in this area, as I maintain an external list of my recurring expenses. Here is a look at a monthly expense set-up check list maintained on *CheckVist*, a free web based tool. I use it to define all of the expense entries I need to set up at the beginning of a new month.



The list contains a general entry (*Description*) that reminds me what to do, followed by one line for each expense entry to put into HARVEST.

I include a short description of the entry, the amount, and the expense category to use. CheckVist uses a handy checklist format for printouts that make this task even easier.

Reporting



Reporting is pretty simple using the HARVEST reporter. During the year, I check expenses by category (as shown in the figure.) At tax time, I use the LAST YEAR setting and ALL categories to generate a complete report. Then I export the data into Excel for a few quick post-processing steps. (HARVEST could help a little here as well…)

First, I sort the exported data by category and date. Next – using the category names as a reminder – I combine categories that are more detailed than Schedule C requires. For example, my categories “Postage & delivery (Other)” and “Printing and Reproduction (Other)” are combined. Finally, I add some category subtotals to compute the figures for the Schedule C expense categories. By the way, saving the Excel file is a great “offline backup” for the source of your business expense data.

So there you go – a simple, cheap and effective way to get a little more from your HARVEST subscription and ease the pain of tax time to boot.

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