Tax Tips for Writers

By Teresa V. M. Stone

Whether you are just starting out in your writing business or an old hand at it, this is the time of year for everyone to review some basic tax rules.

First, let me emphasize that as a serious writer you are a business, whether you are published or not. If you are not seriously pursuing your writing, but rather just dabbling in it here and there, then as far as the IRS is concerned your writing is a hobby and therefore receives less favorable tax treatment.

There are overlapping rules for both the business of writing and the hobby of writing. We will focus primarily on the serious writer who conducts herself as a business.

What are some of the indicators that your writing is a business? Follow the old adage that if it walks like a duck and quacks like a duck, then it's a duck. In other words, what do *real* writers do and how do they do it? First and foremost, they write! They can also belong to a writer's group, attend conferences and conventions that make sense for what and how they write, promote their books ... they do whatever is reasonable and necessary to make their writing a successful and profitable business. By IRS standards they demonstrate an intent to make a profit. This is one of the more critical elements of proving that you are a business.

LOGIC CHECK: as a romance writer, it makes sense for you to attend writer's groups, conferences, conventions, etc. targeted toward the romance genre. However, in the IRS's view it may not make sense for you to attend the same events for mystery or futuristic writers *unless* you can show that you write in both genres *or* are combining genres, which we all know is done. Keep good records of your efforts, such as a writer's diary and all correspondence with editors and publishers, to support this reasoning. Also, if you just attend these events and don't actually write or submit anything to anyone, then you aren't behaving as a writer who wants to be published and therefore make money—and therefore you are not demonstrating an intent to make a profit. So, save those rejection letters. They're worth their weight in terms of proving that you are submitting and intending to make a profit. Of course, a publishing contract works as well!

Business Tax Categories

There are primarily three ways that you can categorize your writing business for the IRS. They are Schedule C, Partnership, or Corporation (S or C). We will focus on the Schedule C option, since it is the most common approach not only for writers but for many small businesses as well.

Unlike a partnership or corporation, Schedule C is an integral part of your individual tax return. Partnerships (there are several flavors) and the S form of a corporation do feed into your individual return, primarily through a document called a K-1, but are not part of your individual income tax return like Schedule C is. Schedule C must be filed with your individual return, while partnerships and corporations file their own separate returns and provide financial information to the partners or members through the K-1 document.

The Schedule C is actually called Net Profit From Business (Sole Proprietorship). There is an EZ version of this form as of a few years ago, but it can only be used if expenses are less than $2500 and there are no other complexities, such as depreciation. The name, Sole Proprietorship, implies that one person owns this business. However, you can have employees and you can count certain participation by your spouse to satisfy material participation rules. If your spouse is truly a partner in the business, then you may need to file a partnership return. Schedule C form instructions have seven tests to determine material participation. The first test, and most commonly used one, requires that you participate in the business activity for more than 500 hours during the tax year.

I strongly urge everyone to keep a diary of time spent. This could be as simple as a spiral notebook or as structured as a day planner. What this helps you prove at the end of the year is how much time you've spent in your trade or business as a writer. It also serves as an excellent cross-reference for your expenses (as discussed next). A minimum of 500 hours a year seems like a lot, but that's less than 10 hours per week, and the serious writers I know spend at least that amount of time and usually more not only writing, but attending writer's meetings and conferences, keeping good books, etc. Again, that's an average and doesn't have to be equally spread out among the weeks, so yes, you can take a vacation.

Why is material participation so important? Without it your business is considered a passive activity, and in this case you are subject to passive loss limitations rules. As a result you may not be able to write off all of your expenses in the current year.

Some common expenses for writers:

- Mileage and travel expenses to writer's group meetings, book signings, conferences, etc.
- Reference materials.
- Writing supplies such as pen and paper.
- Telephone expenses specific to the writing business—second phone line greatly encouraged.
- Computer (may have to be prorated between business and personal if not used exclusively for the writing business).
- Software used for the writing business.

Note: The business code required in Section B of Schedule C that I recommend using is 711510 for independent artists, writers, & performers.

Record-keeping

When you work for someone else and a W-2 is sent to the IRS from the employer, the IRS is fairly confident that the W-2 reflects what you've earned that year from that employer. When you're self-employed, the IRS relies on the information you record on your Schedule C to tell it what you've made and spent. The only true way of challenging this is through an audit. So thorough and reliable record-keeping is essential.

Again, whether you use a spiral notebook or a software program, you want to keep your books (the accounting ones not the fiction ones) in order. At a minimum, you should record the date, the amount of time and/or money spent, who or what it was spent on, and why. If you record this information using a spreadsheet program on a computer, then you can code the information as you go along throughout the year. Then at tax time you can run reports that make it very easy to transfer the information to their appropriate categories on Schedule C.

Similarly, mileage records have at a minimum the date, the distance traveled (you could record beginning and ending odometer readings or the actual measured distance), and the purpose of the trip (e.g., bought supplies, attended RWA meeting, book signing, etc.). Keep a log book in your car so you don't forget to record this information. The IRS is adamant about mileage records. Tolls and parking fees are also deductible, but tickets for parking or moving violations are not.

Remember the IRS loves a paper trail, so keep *all* your receipts and as mentioned above keep a diary to cross-reference with your expenses. (Have I beat this drum enough?)

How long should you keep those records? The minimum I recommend to anyone filing more than a 1040EZ is 10 years. The IRS's official audit window is three years past the filing requirement of the return in question, and it's a seven-year window to prove you actually filed the return. However, if you have any carry-over information, such as office-in-the home, depreciation, etc., it's three years after the last time that item occurred on your return. So, with a small business I say keep them until three years past the disposal of the business. (Get a CD-writer and scanner and archive older ones to CD if you don't want that much paper hanging around, and remember to shred sensitive information before disposing of it.)

Business Use of Your Home

Two tests govern whether or not you can deduct the cost of your office-in-the-home. They are the Exclusive Use and Regular Use tests. Exclusive use means that you use the designated area of your home *only* for your trade or business. Regular use means that you are using that area on a continuing basis. So you can't let your children play in the area or put the Christmas tree up in this area once a year, and no, a corner of your kitchen won't work either.

LOGIC CHECK: Since the purchase and operating costs of business property that is partially used for personal purposes must be prorated, it does not make sense to have an office-in-the-home and in this area have property such as a computer or phone that is also used for personal purposes. If you do this, you've just helped the IRS to disallow your office-in-the-home deduction.

Reference Materials

Each year the IRS updates all of its forms, schedules and publications. The amount of change from year to year will depend on how much Congress has changed the tax code. I just recommend that you get the items I've listed every year by going to the IRS Web site and downloading or printing them. One of the first things noted in each publication are the changes for that year, which I find extremely helpful. Also, form instructions that are specific to that form or schedule are a must-have to understand what the form is asking for line-by-line.

Self-prepared or Professional Preparation

Software now makes it easier than ever to do your own taxes, but as a small-business owner you still need to do an extensive amount of reading. Beyond the 1040EZ I strongly recommend using a tax software program if you are going to prepare your own return. The two leading consumer packages for the past several years have been H&R Block's Tax Cut (a joint effort with Kiplinger) and Turbo Tax from Intuit (the same folks who produce Quicken). All professionals should be using professional versions of their tax software. I also strongly encourage you to electronically file your return to take advantage of the quickness and digital processing of your return. When you mail your return to the IRS, an individual then needs to manually enter your information, opening up opportunities for human error. Electronic filing sends your return

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Materials from the IRS *www.irs.ustreas.gov*:

- Form 1040, Individual Tax Return.
- Form 1040 Instructions.
- Schedule C, Profit or Loss from Business (Sole Proprietor).
- Schedule C Instructions.
- Schedule SE, Self-Employment Tax.
- Schedule SE Instructions.
- Form 8829, Expenses for Business Use of Your Home.
- Form 8829 Instructions.
- Publication 334, Tax Guide for Small Business.
- Publication 535, Business Expenses.
- Publication 583, Starting a Business and Keeping Records.

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from your computer to the IRS's computers, and this is what you want. And, if you're getting a refund, you can have that sent directly to your savings or checking account.

Whether or not you use a professional preparer is primarily dependent upon how comfortable you are with the tax materials you must read and file. You can also prepare the return yourself and then have a professional review it.

Bottom Line

The bottom line is that if you are serious about your writing and serious about getting published, then your business records will reflect that. The IRS has a general rule that is sometimes called the three-out-of-five-year rule. That is, the IRS would like you to make a profit in any three years out of five. This is not a hard and fast rule, but it is a guide that the IRS can and does use. Sometimes it's a guide for them to perform audits. As a Schedule C business, you need to be prepared to be audited. This simply means keeping good books and good records. Even if you don't have a profit in three out of five years, if you can demonstrate to the IRS that you have seriously pursued your writing career and seriously tried to become published and seriously tried to make a profit, then you should be ok. Even the IRS knows that it can take years to get published and the tax court has upheld writing off your reasonable and necessary expenses in the year they occur rather than when the book is published.

Disclaimer: This article does not replace the services and/or advice of a qualified tax professional who has the opportunity to look at your individual tax profile and circumstances and render advice accordingly.

Teresa V. M. Stone has been involved with the education and preparation of taxes for the past nine years. Married to an author whose first novel was published in 1992, she knows firsthand how to negotiate an audit with the IRS concerning the expenses, habits, and write-offs common to writers.

Other sources of information:

www.chicagotribune.com—they have an online small business guide with lots of tax info.

www.sba.gov—this is the U.S. Small Business Administration's Web site with startup kits, etc.

www.handrblock.com

www.forwriters.com/taxes.html

www2.netdoor.com/~smslady/articles/taxes.html

www.writing-world.com/business/index.html#taxes

http://freelancewrite.about.com/careers/freelancewrite/cs/taxes/index.htm