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Audit survival guide for small businesses

Here's a practical guide to walk you through the essentials of a small business audit.

■ STEP 1: Know the types of audits you might face

• **IRS audits.** These focus on federal tax returns such as income, expenses, payroll taxes, & deductions. They can be random, or triggered by red flags like high deductions, inconsistent income, or missing forms.

• **State audits.** State audits often review sales tax, payroll tax, and state income tax filings. Many states also conduct unemployment insurance audits. If you operate in multiple states, expect more scrutiny.

• **Local audits.** These come from city or county agencies. Common triggers can include business license compliance, property taxes, or gross receipts taxes. Some municipalities are aggressive about enforcing these.

■ STEP 2: Keep your books audit-ready throughout the year

- Separate business and personal finances by using a dedicated business account and credit card.
- Keep all receipts and invoices, whether in paper or digital form. Make sure they're well-organized and easy to access if needed.
- Reconcile your bank statements every month to catch and correct any errors early.
- Track mileage and travel expenses as they happen. Reconstructed logs may not hold up during an audit.

■ STEP 3: Surviving the audit – What to do

- Read the notice carefully. Know what's being audited and for which years.
- Respond promptly. Deadlines matter.
- Get professional help. Call for help to create a plan of action.
- Provide only what is necessary.

■ STEP 4: Surviving the audit – What NOT to do

- Argue or get defensive. Keep it professional.
- Show up unprepared. If they request a site visit, make sure everything looks orderly and legitimate.
- Don't answer questions they don't ask you.
- Assume they're wrong. They might be wrong, but prove it with documents and evidence.

■ STEP 5: Stay ahead of the next audit

- Always file on time.
- Do an annual self-audit, especially for sales tax and payroll.
- Train your staff. If they touch money or records, they need to know the rules.
- Review local rules yearly. Cities often change tax and licensing laws.

Ask for help. Don't do this alone. ♦

NOTE: This newsletter is issued quarterly to provide you with an informative summary of current business, financial and tax planning news and opportunities. Do not apply this general information to your specific situation without additional details. Be aware that the tax laws contain varying effective dates and numerous limitations and exceptions that cannot be summarized easily. For details and guidance in applying the tax rules to your individual circumstances, please contact us.

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Tax & Business letter

SPRING
2026

PROTECT YOUR BUSINESS FROM TAX SCAMS! *Small businesses are targets*

Cybercriminals see small businesses as easy wins because they often store sensitive data such as customer information, employee Social Security numbers, bank details, and tax information without the security barriers common with most larger companies. Here are several scams to be on the lookout for and what you can do to protect your business.

Common scams

In recent years, the IRS has reported a rise in phishing scams targeting small businesses, especially during the weeks leading up to a tax deadline. These scams often attempt to steal sensitive information such as login credentials, W-2 forms, and employer identification numbers (EINs). Criminals can use this data to file fake tax returns or open lines of credit in the business's name. Here are some of the more common tax-related scams to watch out for:

Phishing emails pretending to be from the IRS, tax software providers, or financial institutions

Fake refund notifications prompting you to click malicious links or share banking details

Business email compromise scams where attackers pose as executives requesting W-2s or wire transfers

Ransomware disguised as tax document attachments

Calls or texts claiming to be from the IRS that threaten audits or legal action unless you provide sensitive info

Spoofed websites that mimic legitimate tax platforms to steal login credentials

How to protect your business

The good news is you don't need a huge IT budget to reduce your risk. Strong cybersecurity comes down to consistency, awareness, and a few essential tools.

Here's a checklist to help safeguard your business during both tax filing deadlines and throughout the year.

► **Start with a Written Information Security Plan (WISP),** a practical road map that walks your business through the actions needed to strengthen online security. The IRS provides a helpful checklist with Form 4557, so review this document as it relates to your business.

► **Update all software regularly,** including operating systems and antivirus tools.

► **Use strong, unique passwords** and enable multi-factor authentication (MFA) for all key systems.

► **Secure your Wi-Fi networks,** especially if employees are working remotely.

► **Back up data routinely** and store backups offline or in a secure, encrypted cloud service.

► **Limit access to sensitive data.** Only give access to employees who need it.

► **Train your team on phishing and social engineering** regularly and with real-world examples.

► **Verify email requests** for W-2s, tax forms, or financial transfers, especially those that seem urgent.

► **Use secure file-sharing methods.** Never send personal information over email without encryption.

► **Shred physical documents** containing sensitive data before discarding.

► **Monitor your business credit reports** for unusual activity or new accounts you didn't open. ♦



IRSTAX NOTES

Business mileage rate for 2026 set at 72.5 cents

Mileage rates for travel are now set for 2026. The standard business mileage rate increases by 2.5 cents to 72.5 cents per mile. The medical and moving mileage rates decrease 1/2 cent to 20.5 cents per mile.

- These rates apply to gas, electric, hybrid-electric, and diesel-powered vehicles.
- You cannot claim mileage as an itemized deduction as an employee if you aren't reimbursed for travel expenses.
- Claiming a mileage deduction for moving expenses is not allowed unless you are an active member of the Armed Forces and are ordered to move to a new permanent duty station.

Remember to properly document your mileage to receive full credit for your miles driven.

Interest rates unchanged for first quarter of 2026

Interest rates for the first quarter in 2026 are unchanged compared to last quarter. These rates include: 7% for overpayments (6% for corporations); 4.5% for the portion of a corporate overpayment over \$10,000; 7% for underpayments and 9% for large corporation underpayments. ♦

Tax CALENDAR

April 15, 2026

- 2025 individual income tax returns are due.
- First installment of 2026 individual estimated tax is due.

June 15, 2026

- Second installment of 2026 individual estimated tax is due.

SMART WAYS TO PULL MONEY FROM YOUR BUSINESS

WITHOUT TAX TROUBLE

When you own a business, paying yourself isn't just about cutting a check, it's also about staying compliant and profitable. Here are several ideas to help pay yourself with confidence and keep the IRS off your back.

Draw the line between you and your business

Your company's money and your personal money need their own space. When you blur these lines you risk your legal protection and credibility.

Why it helps: Keeping business and personal funds separate makes taxes cleaner and protects your liability shield. When you commingle personal and business expenses, the IRS can quickly disallow otherwise legitimate business deductions.

How to do it right:

- Open dedicated business accounts and credit cards.
- Transfer funds for personal use instead of paying directly from business accounts.
- Label every transfer clearly as a draw, distribution, or salary.

Pay a reasonable salary

If you're running an S corporation, you wear two hats: employee and owner. This means you can't skip paying yourself a reasonable salary just to dance around payroll taxes.

Why it helps: A fair salary keeps you in the IRS's good graces and lets you enjoy the tax perks of distributions without crossing the line.

How to do it right:

- Research what someone in your role would earn.
- Run payroll and pay yourself consistently.
- Take distributions on top of that once your salary is covered. ♦



“Intentional withdrawals protect your cash flow, simplify book-keeping, and give you a clear picture of what's available.”

Know your basis – so you don't pay tax twice

If you're part of a partnership or S corporation, there's a quiet number that rules your world: basis. It decides how much money you can take out tax-free.

Why it helps: Understanding your basis keeps you from accidentally creating taxable income when you pull cash from your business.

How to do it right:

- Track your capital contributions, profit allocations, and prior withdrawals.
- Keep an annual record of your basis.
- Double-check before taking large distributions.

Manage cash withdrawals

When making withdrawals from your business outside of your regular salary, create an organized process.

Why it helps: Intentional withdrawals protect your cash flow, simplify book-keeping, and give you a clear picture of what's available.

How to do it right:

- Set a consistent draw or distribution schedule.
- Sync it with your budget and tax estimates.
- Record everything accurately in your accounting system. ♦

NUMBERS to know from your tax return

Your tax return contains many of the answers you need to make great business decisions during the upcoming year.

With this in mind, here are several numbers you should know from your business's tax return.

$$\text{Effective tax rate} = \frac{\text{Total tax liability}}{\text{Total income}}$$

Take your total tax liability from your most recent tax return and divide it by your gross income from that return. Do this calculation for your three most recent tax returns and compare the results.

If your effective tax rate increased, it may mean certain deductions dropped off, income grew faster than expected, or your business structure is no longer a good fit. A decrease could be a sign of one-time factors that may not repeat, like the purchase of expensive equipment.

(Note: Remember if you have a pass-through entity, your business's tax liability will be found on your individual tax return.)

Planning tip: Use this rate to estimate future tax costs more accurately, so you can set aside the right amount of cash. It can also be used to evaluate whether changes to compensation, retirement contributions, or entity type are worth exploring in 2026.

$$\text{Owner tax burden} = \frac{\text{Total tax liability}}{\text{Total owner compensation (or distributions)}}$$

Owner tax burden looks at how much of the cash an owner takes out of the business ultimately goes to taxes. A high owner tax burden may signal that compensation is structured inefficiently, estimated payments are off, or the entity type is creating unnecessary tax friction.

Planning tip: This number can guide changes to how you pay yourself (salary vs. distributions), timing of bonuses, retirement contributions, and even whether a different business structure would leave more cash in your hands.

$$\text{Operating expense ratio} = \frac{\text{Total operating expenses}}{\text{Total revenue}}$$

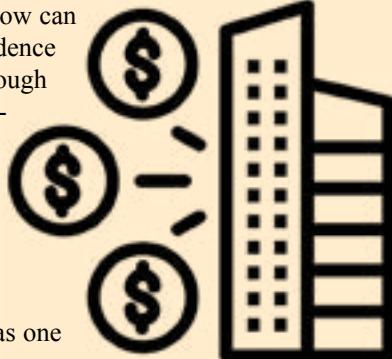
This ratio gives a clear view of how efficiently the business runs day-to-day. A rising ratio often signals creeping overhead. Expenses may be increasing faster than revenue, even if total profit still looks acceptable. A falling ratio usually points to improved efficiency, better pricing, or stronger cost control. Neither is good or bad on its own, but comparing ratios over time matters.

Planning tip: Use this ratio as a guardrail when making spending decisions. Before adding a new cost, look at how it would affect this ratio if revenue stays flat. If the number starts creeping up, it's often a sign to slow hiring, renegotiate costs, or adjust pricing before margins erode. ♦

CASH FLOW CORNER

Building your cash flow forecast for the upcoming year

Forecasting your cash flow can help you say with confidence how cash will move through your business month-by-month in the year ahead. Here are several ideas for building your own forecast.



The three scenarios

The art of forecasting has one certainty – you will be wrong. Because of this, a great forecast creates a range of outcomes from worst to best case.

• **Start with your most likely case.** This is your baseline and should be based on facts you already know. Review last year's cash inflows and outflows, current customer contracts, typical payment timing, and recurring expenses. Lay this out month-by-month so you can see patterns like seasonality or predictable dips.

• **Next, create a best case scenario.** This version assumes things go a bit better than expected. Customers pay faster, sales come in slightly higher, or costs stay lower than planned. The purpose of this scenario is to understand how much flexibility you might have if conditions improve. It can help you decide ahead of time how you would use extra cash, whether that means paying down debt, building reserves, or investing back into the business.

• **Then build a worst case scenario.** This assumes delays, slower sales, or higher costs. This case isn't about being pessimistic, but rather about understanding risk. By seeing how cash would be affected if something goes wrong, you can identify which expenses could be reduced, how long existing cash would last, and when you might need to arrange financing. When these three scenarios are viewed together – best, worst, and most likely – you gain a clearer picture of what's possible and where your biggest pressure points are.

Getting started

- **Create historical results** by using the prior year to help create a reasonable look into the future.
- **Build a simple monthly forecast** for 2026 that focuses on cash timing rather than accounting profit. Use three versions so you can compare outcomes side-by-side.
- **Review your forecast** regularly and update it as real numbers replace estimates. Use what you learn to guide spending, pricing, and planning decisions throughout the year. ♦