

Cost of Goods Sold

Do you have a business that sells a product? If you do, you and your tax preparer will have to determine what it costs you to acquire the product that you sold. This seems obvious. However, business owners often get this concept wrong. That's because the amount you get to deduct is limited to the cost of what you actually sold... not the TOTAL cost to acquire product(s).



Why is Cost of Goods Sold important to you?

- Because money spent on products that didn't sell can't be deducted in the current tax year... it must be deducted in a **future** tax year (when the product sells) or may never be deducted at all (if the product never sells or if you used the product for personal use).
- Because it requires special recordkeeping (so your tax preparer can file an accurate return).

What your tax preparer will need to know?

1. The amount spent for: raw materials, the shipping of these materials to your business, the labor of people directly involved in the creation of the product, or other materials which became part of the product.
2. If you are simply buying products for resale your task is much simpler. You just need information on how much the product cost you to obtain.
3. The cost of items that you use yourself.
4. The cost of items that you use for promotional use (give aways etc.).
5. How much of your inventory you have left at year end, and how much that ending inventory cost you.

This is enough to determine Cost of Goods Sold.

In simple terms; what you spent, less the amount left over, becomes what you had to pay for what your customers purchased. This is the only expense that that can be used to reduce your business profit, and thus the amount of tax you will pay. What it cost you to acquire what **did not** sell will be included in your inventory in the coming year.

What should you do?

If this still sounds a little too complicated then do not fear. There are ways to simplify the process. One way is to keep track of the cost and sales of each individual product/SKU on a separate worksheet. Your tax preparer will know how to calculate the Cost of Goods Sold based on this information.