# Personal funds vs. business funds

The most common mistake business owners make is not keeping personal and business funds separate.

**Why Not Mix Business and Personal Funds**
First, some reasons why it is not a good idea to mix business and personal funds:

* It doesn't look professional. If you are dealing with a vendor or customer and you pull out your personal checkbook or credit card to pay a business expense, you are giving the impression that you are not a real business owner.
* In the same way, lack of separation shouts "hobby" to the IRS. And the IRS is quick to deny deductions and losses for hobbies. If you want the IRS to look at your business as legitimate and not a hobby, keep business and personal separate.
* Clear deductions and income. If you want to be able to claim expenses as deductions, you must be able to show that these deductions were for business purposes. Trying to sort through your personal records at tax time is a nightmare. Capture business expenses in your business account to make it easier to claim those deductions.
* Make it easy for the IRS. As noted above, the IRS is more likely to audit your business and deny deductions and businesses losses if you have no clear separation between business and personal expenses. If you have a home-based business, for example, the IRS might not allow home business expenses if they are not separate.

**Arms-Length Transactions**
All transactions between you personally and the business must be "arms length;" that is, the transactions clearly separate you as a personal entity and the business as an entity. Here are some examples of how this might work:

**Keeping Separate Accounts**
First, and most important, set up separate checking accounts for business and personal use. Write checks for business purchases from the business account and personal purchases from the personal account. Put business income in the business account and personal income in the personal account. Do the same with credit card accounts - one for business and one for personal - and don't mix charges or payments for these accounts.

**Contributing property or cash**
If you put money in the business in the form of property or cash, clearly designate how the money is to be considered - as a loan or as an owner investment. You can choose either a loan or an investment, but make sure the paperwork is complete and that it is easy to see how the transaction is considered on the books of the business.

**Taking Money Out of the Business**
If you are an employee, pay yourself a reasonable salary, based on comparable salaries for other similar positions.
If you are a sole proprietor or partner, you can take a draw by writing a check to yourself from the business account.

**Renting a Location**
If you are using part of your home for business, you could rent space to your business. Create paperwork to show this rental agreement, including all the terms and conditions.

**If you Make a Mistake**
An occasional mistake is only human. Just make sure you document the mistake and edit the transaction in your business records. For example, if you deposit a personal check in your business account, label it as owners equity; if you need to take the money back out, enter the check as a draw on your owners equity. If you forget and pay for something with your personal credit card, label this as an investment also. Just make sure that you have correctly labeled the mistakes in your business records.

In general, every transaction between yourself and the business must be clearly labeled, at arms length, and reasonable. You will find that once you get into the habit this will be easy to do.