

# Volunteer Tax Alert 2012- 03 March 7, 2012

## How to Report Self-Employment Income

**Identified error:** Some volunteer preparers are not correctly reporting self-employment income.

**General rule:** Taxpayers must include all items of income that are received in the form of cash, property, and services, unless the tax law specifically excludes. This includes all self-employment income (such as cash) even if the taxpayer does not receive a 1099-MISC.

Some volunteer preparers are omitting cash income or are erroneously reporting self-employment income as other income on Form 1040, line 21. Cash income earned in the taxpayer's business and *Form 1099-MISC Income; box 7, Nonemployee Compensation*, is self-employment income and should be reported on Schedule C-EZ or C. The net earnings from self-employment income of \$400 or more is subject to self-employment tax. All cash income earned from a business operated by the taxpayer is reported on Schedule C-EZ or C even if there is no tax document reporting the income to IRS.

**Level of Certification:** Intermediate - To prepare tax returns for self-employed taxpayers volunteer preparers must be certified through the intermediate certification level.

**Limited Scope:** Volunteer preparers must be cautious to only prepare Schedule C-EZ or C returns that are within scope. In general, only Schedule C-EZ returns are in scope. To qualify to report self-employment income on Schedule C-EZ:

<b>If the taxpayer:</b>	<b>and the taxpayer:</b>
<ul style="list-style-type: none"><li>• Had business expenses of \$5000 or less.</li><li>• Use the cash accounting method.</li><li>• Had no inventory at any time during the year.</li><li>• Did not have a net loss from this business</li><li>• Had only <b>one</b> business as either a sole proprietor or statutory employee</li><li>• Did not receive any credit card or similar payments that included amounts that are not includible in income</li></ul>	<ul style="list-style-type: none"><li>• Had no employees during the year.</li><li>• Is not required to file <b>Form 4562</b>, Depreciation and Amortization, for this business.</li><li>• Does not deduct expenses for business use of the home.</li><li>• Does not have prior year un-allowed passive activity losses from this business.</li></ul>

If the self-employment income cannot be reported on Schedule C-EZ because expenses are more than \$5,000, Schedule C should be prepared. Schedule C expenses are limited to \$10,000 or less. **Note: These scope limitations do not include the sites participating in the IRS Schedule C pilot.**

**How to Report:** Form 1099-MISC with nonemployee compensation (box 7) is reported on line 1b of Schedule C or C-EZ by linking to Form 1099-MISC from line 1b. Link and complete a separate Form 1099-MISC for each Form 1099-MISC that the taxpayer provides. For cash income, link to a scratch pad from line 1b of the Schedule C or C-EZ and enter all cash income received for the business. TaxWise will add all Forms 1099-MISC and cash income totals to line 1b of Schedule C-EZ or C. Self-employment tax and the adjustment of the deductible portion of the self-employment tax are automatically calculated by TaxWise and carried to the appropriate forms. **Note:** when using the interview option in TaxWise, the software will create a separate Schedule C or C-EZ for each Form 1099-MISC entered. If you want to use the interview feature, when you get to the **Types of Income** screen at **Add Item** click the down arrow and choose BUSINESS/1099-MISC and click **Add**, then enter the total amount of all Forms 1099-MISC and reported Business Income in the Amount box.

**For more information, review the following resources:**

- Publication 4012, *VITA/TCE Volunteer Resource Guide pages 2-7 and 2-8*
- Publication 17, *Your Federal Income Tax*, or
- Publication 334, *Tax Guide for Small Business*

If you have any questions, please discuss them with your site coordinator, contact your local IRS SPEC relationship manager, or e-mail [partner@irs.gov](mailto:partner@irs.gov).

**Thank you for volunteering to serve your community and for your dedication to providing top QUALITY service!**