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# ACE Your Deductions: Schedules A, C, and E Hot Button Issues

Presented by

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# IRS Reminds 21,000 Preparers

- ...of the obligation to prepare accurate tax returns on behalf of their clients.
- Letters sent to paid preparers who complete large volumes of tax returns with Schedules A, C or E
- IRS targeted preparers of returns with attributes they believed were likely to contain tax law inaccuracies and misinterpretations



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# Why the Letters?

- IRS views the program as a hands-on effort to improve return accuracy and quality and to heighten preparer responsibility awareness
- Preparers are expected to have tax law knowledge and prepare accurate returns while exercising due diligence



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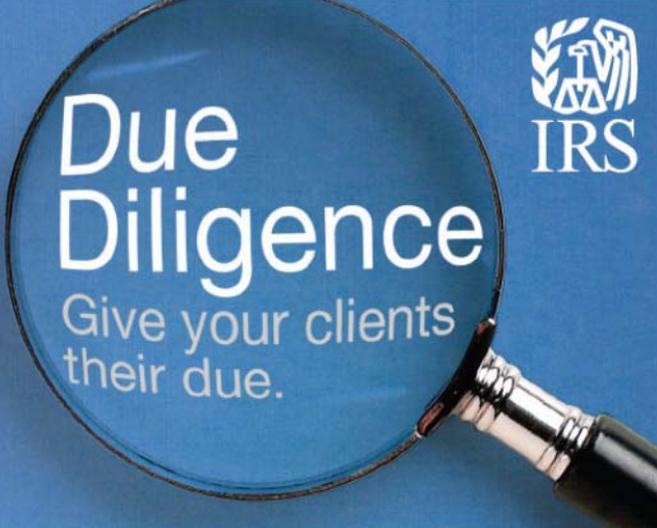
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# Due Diligence

- Due diligence refers to the level of judgment, care, prudence, determination, and activity that a person would reasonably be expected to do under particular circumstances

## The Due Diligence Must Do's

Know the law  
Ask all the right questions  
Get all the facts  
Document as you go

A magnifying glass with a black handle is positioned over the IRS logo. The lens of the magnifying glass is focused on the text "Due Diligence" and "Give your clients their due." The IRS logo, featuring a scale of justice and the letters "IRS", is visible in the top right corner of the graphic.

Due  
Diligence  
Give your clients  
their due.



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# We don't have to audit our clients!

- In general, preparers may rely in good faith upon client-provided information
- BUT, preparers may not ignore the implications of information known or reasonably suspected to be untrue, incomplete, inconsistent or inaccurate
- Positions on the return must reflect a reasonable basis – with disclosure



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# Schedule A Hot Buttons

- Charitable contributions
- Form 2106
  - Unreimbursed employee business expenses
  - Mileage claimed
- Travel, meals & entertainment expense
- Other expenses appearing as miscellaneous deductions



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**SCHEDULE A  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Itemized Deductions**

▶ Attach to Form 1040. ▶ See Instructions for Schedule A (Form 1040).

OMB No. 1545-0074

**2011**

Attachment  
Sequence No. **07**

<b>Gifts to Charity</b> If you made a gift and got a benefit for it, see instructions.	<b>16</b>	Gifts by cash or check. If you made any gift of \$250 or more, see instructions. . . . .				
	<b>17</b>	Other than by cash or check. If any gift of \$250 or more, see instructions. You <b>must</b> attach Form 8283 if over \$500 . . . .				
	<b>18</b>	Carryover from prior year . . . . .				
	<b>19</b>	Add lines 16 through 18 . . . . .				<b>19</b>
<b>Casualty and Theft Losses</b>	<b>20</b>	Casualty or theft loss(es). Attach Form 4684. (See instructions.) . . . . .				<b>20</b>
<b>Job Expenses and Certain Miscellaneous Deductions</b>	<b>21</b>	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.) ▶ _____				
	<b>22</b>	Tax preparation fees . . . . .				
	<b>23</b>	Other expenses—investment, safe deposit box, etc. List type and amount ▶ _____				
	<b>24</b>	Add lines 21 through 23 . . . . .				
	<b>25</b>	Enter amount from Form 1040, line 38 <b>25</b> _____				
	<b>26</b>	Multiply line 25 by 2% (.02) . . . . .				
	<b>27</b>	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0- . . . . .				<b>27</b>
<b>Other Miscellaneous Deductions</b>	<b>28</b>	Other—from list in instructions. List type and amount ▶ _____				<b>28</b>



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# Schedule C Hot Buttons

- Gross receipts not fully reported
  - Books and records should be available for review to substantiate amounts reported
- Expenses claimed must be ordinary and necessary for the type of business reported
- All income and appropriate expenses should be reflected.



**SCHEDULE C  
(Form 1040)**

**Profit or Loss From Business**  
(Sole Proprietorship)

OMB No. 1545-0074

**2011**  
Attachment  
Sequence No. **09**

Department of the Treasury  
Internal Revenue Service (99)

► **For information on Schedule C and its instructions, go to [www.irs.gov/schedulec](http://www.irs.gov/schedulec)**  
► **Attach to Form 1040, 1040NR, or 1041; partnerships generally must file Form 1065.**

Name of proprietor		Social security number (SSN)
<b>A</b>	Principal business or profession, including product or service (see instructions)	<b>B</b> Enter code from instructions ▶
<b>C</b>	Business name. If no separate business name, leave blank.	<b>D</b> Employer ID number (EIN), (see instr.) 
<b>E</b>	Business address (including suite or room no.) ▶ City, town or post office, state, and ZIP code	
<b>F</b>	Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶	
<b>G</b>	Did you "materially participate" in the operation of this business during 2011? If "No," see instructions for limit on losses	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>H</b>	If you started or acquired this business during 2011, check here	<input type="checkbox"/>
<b>I</b>	Did you make any payments in 2011 that would require you to file Form(s) 1099? (see instructions)	<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>J</b>	If "Yes," did you or will you file all required Forms 1099?	<input type="checkbox"/> Yes <input type="checkbox"/> No

**Part I Income**

<b>1a</b>	Merchant card and third party payments. For 2011, enter -0-			
<b>1b</b>	Gross receipts or sales not entered on line 1a (see instructions)			
<b>1c</b>	Income reported to you on Form W-2 if the "Statutory Employee" box on that form was checked. <b>Caution.</b> See instr. before completing this line			
<b>d</b>	<b>Total gross receipts.</b> Add lines 1a through 1c		<b>1d</b>	
<b>2</b>	Returns and allowances plus any other adjustments (see instructions)		<b>2</b>	
<b>3</b>	Subtract line 2 from line 1d		<b>3</b>	
<b>4</b>	Cost of goods sold (from line 42)		<b>4</b>	
<b>5</b>	<b>Gross profit.</b> Subtract line 4 from line 3		<b>5</b>	
<b>6</b>	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)		<b>6</b>	
<b>7</b>	<b>Gross income.</b> Add lines 5 and 6		<b>7</b>	

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Part II Expenses		Enter expenses for business use of your home only on line 30.					
8	Advertising . . . . .	8		18	Office expense (see instructions)	18	
9	Car and truck expenses (see instructions). . . . .	9		19	Pension and profit-sharing plans . . . . .	19	
10	Commissions and fees . . . . .	10		20	Rent or lease (see instructions):		
11	Contract labor (see instructions)	11		a	Vehicles, machinery, and equipment	20a	
12	Depletion . . . . .	12		b	Other business property . . . . .	20b	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions). . . . .	13		21	Repairs and maintenance . . . . .	21	
14	Employee benefit programs (other than on line 19). . . . .	14		22	Supplies (not included in Part III) . . . . .	22	
15	Insurance (other than health)	15		23	Taxes and licenses . . . . .	23	
16	Interest:			24	Travel, meals, and entertainment:		
a	Mortgage (paid to banks, etc.)	16a		a	Travel . . . . .	24a	
b	Other . . . . .	16b		b	Deductible meals and entertainment (see instructions) . . . . .	24b	
17	Legal and professional services	17		25	Utilities . . . . .	25	
28	<b>Total expenses</b> before expenses for business use of home. Add lines 8 through 27a . . . . . ▶			26	Wages (less employment credits) . . . . .	26	
29	Tentative profit or (loss). Subtract line 28 from line 7 . . . . .			27a	Other expenses (from line 48) . . . . .	27a	
30	Expenses for business use of your home. Attach <b>Form 8829</b> . Do <b>not</b> report such expenses elsewhere . . . . .			b	<b>Reserved for future use</b> . . . . .	27b	
31	<b>Net profit or (loss)</b> . Subtract line 30 from line 29.						
	<ul style="list-style-type: none"> <li>• If a profit, enter on both <b>Form 1040, line 12</b> (or <b>Form 1040NR, line 13</b>) and on <b>Schedule SE, line 2</b>. If you entered an amount on line 1c, see instr. Estates and trusts, enter on <b>Form 1041, line 3</b>.</li> <li>• If a loss, you <b>must</b> go to line 32.</li> </ul>						31
32	If you have a loss, check the box that describes your investment in this activity (see instructions).						
	<ul style="list-style-type: none"> <li>• If you checked 32a, enter the loss on both <b>Form 1040, line 12</b>, (or <b>Form 1040NR, line 13</b>) and on <b>Schedule SE, line 2</b>. If you entered an amount on line 1c, see the instructions for line 31. Estates and trusts, enter on <b>Form 1041, line 3</b>.</li> <li>• If you checked 32b, you <b>must</b> attach <b>Form 6198</b>. Your loss may be limited.</li> </ul>						32a <input type="checkbox"/> All investment is at risk.
							32b <input type="checkbox"/> Some investment is not at risk.

For Paperwork Reduction Act Notice, see your tax return instructions.

Cat. No. 11334P

Schedule C (Form 1040) 2011



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# More Schedule C Issues

- All expenses claimed are to be paid or incurred during the taxable year and the allowable amount of the expense must be correctly computed
- Be careful what you put in “Other Expenses”
- See Rev. Proc. 2012-15



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- Rental income and expenses improperly reported
- Rental depreciation incorrectly calculated
- Limitations surrounding passive activities, basis and at-risk rules not properly considered or calculated



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SCHEDULE E (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Supplemental Income and Loss (From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)

Attach to Form 1040, 1040NR, or Form 1041. See separate instructions.

OMB No. 1545-0074

2011

Attachment Sequence No. 13

Name(s) shown on return

Your social security number

A Did you make any payments in 2011 that would require you to file Form(s) 1099? (see instructions) B If "Yes," did you or will you file all required Forms 1099?

Part I Income or Loss From Rental Real Estate and Royalties Note. If you are in the business of renting personal property, use Schedule C or C-EZ (see instructions). If you are an individual, report farm rental income or loss from Form 4835 on page 2, line 40.

Caution. For each rental property listed on line 1, check the box in the last column only if you owned that property as a member of a qualified joint venture (QJV) reporting income not subject to self-employment tax.

Table with 5 main columns: 1 Physical address of each property, 2 For each rental real estate property listed, report the number of days rented at fair rental value and days with personal use, Fair Rental Days, Personal Use Days, QJV. Sub-columns A, B, C for days.

Type of Property:

- 1 Single Family Residence, 2 Multi-Family Residence, 3 Vacation/Short-Term Rental, 4 Commercial, 5 Land, 6 Royalties, 7 Self-Rental, 8 Other (describe)

Income and Expenses table with columns for Properties A, B, C and rows for 3a Merchant card and third party payments, 4 Total not including amounts on line 3a, 5 Advertising, 6 Auto and travel, 7 Cleaning and maintenance, 8 Commissions, 9 Insurance, 10 Legal and other professional fees, 11 Management fees, 12 Mortgage interest paid to banks, etc., 13 Other interest, 14 Repairs, 15 Supplies, 16 Taxes, 17 Utilities, 18 Depreciation expense or depletion, 19 Other (list), 20 Total expenses.



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# Rental Rules are Complex

- Limitations may need to be applied if you have a net loss on Schedule E
- The most frequently encountered limit is that imposed by the passive activities rules of IRC §469
- There's also an exception to the limits for real estate professionals



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# The Passive Activity Rules

- ...are related to an owner's ability to deduct losses he incurs from the operations of the rental
- Some taxpayers entitled to an income-based "Active Participation" exception
- Use Form 8582 to calculate the limits and track accumulated losses



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# Real Estate Professionals

- By election, qualifying real estate professionals may group their real estate activities so they may combine time spent in operating them to qualify as material participation
- Doing so avoids the passive activity limits
- **CAUTION!** Don't let your clients tell you the rules on this one!



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