

Schedule C Issues Facing the Tax Professional

National Society of Tax Professionals

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Sole Proprietorship Operation

Simplest business entity to create

One owner: no agreements required and files
no documents with federal government

Capital structure not independent from the
owner

No separate federal income tax return
required: **Form 1040-Schedule C**



Tax Return Filing Requirements

No separate income tax return filed for a sole proprietorship

The “*check-the-box*” regulations provide individual business owners with:

1. Limited liability and
2. Pass through taxation

A single member LLC files a **Schedule C**

Separate businesses owned by same individual: file a *separate* **Schedule C's**



A Separate Schedule C for Each Separate Business

Rev. Rul. **81-90**

Prevents disguising losses of one activity against another activity with gains

Sec. 6011(a) provides that regulations may prescribe separate reporting in instructions and forms

Sec. 6662(a) accuracy penalties may be imposed if intentional disregard or negligence



Husband & Wife Businesses

“Qualified Joint Ventures” of married couples not treated as partnerships

Conduct of a “trade or business” where both spouses materially participate

An “*election*” made by both spouses to allocate income, deductions and credits based on respective ownership interest

Separate **Schedule C** for each spouse



A Separate Schedule S/E

Addresses issues dealing with the “tax gap”

Could increase overall tax liability on **Form 1040**

Separate “social security” benefits for each spouse

Defines “legal ownership interest” in the business



Ease of Liquidation or Sale

Transfer of business ownership: an asset by asset disposition by sole proprietor

Gain or loss recognized on each business asset both tangible and intangible

Measure difference of FMV of each asset against adjusted basis on date of disposition

Subjected to “recapture” rules



Sec. 280A

Home Office Deduction

Principal place of business test

Used “*exclusively and regularly*” by taxpayer to conduct “*administrative or management activities*” of a trade or business

No other **fixed location** where taxpayer conducts “*substantial*” administrative or management activities of ***the*** business



Home Office Deduction

The “function” test of the Solimon decision
not an issue

House Committee Report support

Taxpayer may perform administrative and
management activities at another location
where activity not substantial

Substantial non-administrative and non-
management activity at another location



Medical Insurance Premiums

Sec. 162(l) provides deductibility: **Page 1 of Form 1040** for Health and Long-term Care (age limitations)

Coverage for taxpayer, spouse and dependents

Months during year when taxpayer is self-employed

Not eligible to participate in a subsidized plan



Pension Plans Available

Simplified Employee Pensions: SEPs

Keogh and Profit Sharing Plans

Individual **Sec. 401(k)** Plans

SIMPLE Plans



Hiring of Related Parties

Deductible compensation and benefits allowable for spouses and children providing services to or for the business

Children under age 18 not subjected to Social Security and Medicare

Reduction of taxpayer's AGI

Reduction of family unit's tax



Hobby vs. Business & At-Risk Limitations

Sec. 183: no deduction for an activity not engaged in for profit

Deductions to extent of income generated from the particular activity

Burden of proof: **Reg. Sec. 1.183-2(b)** factors which help in determining trade or business status

At-risk Issues: **Sec. 465(b)(3)(C), 267(b) & 707(b)(1)**

