

Schedule C Issues Facing the Tax Professional

National Society of Tax Professionals

Paul La Monaca, Director of Education



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



Simplified Option: Rev. Proc. 2013-13

- **\$5** Standard deduction on a *maximum* of **300** Sq. Ft. :
Maximum Deduction **\$1,500**
- **No** deduction allowed for *mortgage interest* and *real estate taxes* for home office purposes
- **No** *depreciation* deduction and **no** *recapture*
- Standard Deduction *limited* to gross income from the business and cannot be carried over and claimed as a deduction in any other year



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

- **Sec. 183:** no deduction for an activity not engaged in for profit
- Deductions to extent of income generated from the particular activity
- **Reg. Sec. 1.183-2(b)** factors which help in determining trade or business status
- Burden of proof

