North Carolina Chapter NATP National Association of Tax Professionals

# 2023 Annual Conference
# Filing Schedule C

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## Objectives

- At the end of this course, you will be able to:
  - Describe types of Schedule C income and expenses
  - Explain the alternative to keeping inventory
  - Analyze the options for vehicle deductions

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# Schedule C Header

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# Once You've Decided It's a Business…

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SCHEDULE C (Form 1040)
Department of the Treasury Internal Revenue Service

**Profit or Loss From Business**
**(Sole Proprietorship)**
**Go to *www.irs.gov/ScheduleC* for instructions and the latest information.**
**Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships must generally file Form 1065.**

OMB No. 1545-0074
2022
Attachment Sequence No. 09

Name of proprietor | **Social security number (SSN)**

A Principal business or profession, including product or service (see instructions) | **B Enter code from instructions**

C Business name. If no separate business name, leave blank. | **D Employer ID number (EIN)** (see instr.)

E Business address (including suite or room no.)
City, town or post office, state, and ZIP code

F Accounting method: (1) ☐ Cash (2) ☐ Accrual (3) ☐ Other (specify)

G Did you "materially participate" in the operation of this business during 2022? If "No," see instructions for limit on losses ☐ Yes ☐ No

H If you started or acquired this business during 2022, check here ☐

I Did you make any payments in 2022 that would require you to file Form(s) 1099? See instructions ☐ Yes ☐ No

J If "Yes," did you or will you file required Form(s) 1099? ☐ Yes ☐ No

**Why do I care about material participation?**

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# Material Participation Reg §1.469-5T

- Line G: Did you materially participate in the operation of this business during 2022?

1. **Taxpayer put in more than 500 hours in this activity during the year**
2. **Taxpayer's participation was all the participation in the activity by all individuals**
3. **Taxpayer put in more than 100 hours, which was at least as much as anyone else**
4. The activity is a significant participation activity and the taxpayer participated more than 500 hours in all significant participation activities for the year
5. **Taxpayer materially participated in any five of the last 10 years**
6. **The activity is a personal service activity in which the taxpayer materially participated in any three prior tax years**
7. If the taxpayer participated in the activity more than 100 hours on a regular, continuous and substantial basis during the year, the facts and circumstances test is available.

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# Cash vs. Accrual

- The key difference between the cash basis and accrual basis methods of accounting is one of timing.
- **Cash-Basis Accounting**: This accounting method documents earnings received and expenses when paid. The focus is on the business's cash flow, tracking money that comes in as revenue or goes out as expenses paid.
- **Accrual-Basis Accounting**: This accounting method accounts for earnings the moment they are owed to the business, and expenses the moment the business owes them. Money not yet received may be included in income; bills not yet paid may be included in expenses.
- Almost all small businesses use the cash method. Sometimes the client prints out a QuickBooks report that has defaulted to "accrual." This does not necessarily mean the business operates on an accrual basis. It may simply mean that the client didn't print the proper report.

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# Watch for Trick Questions!

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G Did you "materially participate" in the operation of this business during 2022? If "No," see instructions for limit on losses . ☐ **Yes** ☐ **No**

H If you started or acquired this business during 2022, check here . . . . . . ☐

I Did you make any payments in 2022 that would require you to file Form(s) 1099? See instructions . . . . ☐ **Yes** ☐ **No**

J If "Yes," did you or will you file required Form(s) 1099? . . . . . ☐ **Yes** ☐ **No**

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# Income

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# Schedule C Part I, Income

| Part I | Income | | |
|---|---|---|---|
| 1 | Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked ▶ ☐ | 1 | |
| 2 | Returns and allowances | 2 | |
| 3 | Subtract line 2 from line 1 | 3 | |
| 4 | Cost of goods sold (from line 42) | 4 | |
| 5 | **Gross profit.** Subtract line 4 from line 3 | 5 | |
| 6 | Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) | 6 | |
| 7 | **Gross income.** Add lines 5 and 6 ▶ | 7 | |

**What's a statutory employee?**

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# Statutory Employee

- If workers are independent contractors under the common law rules, such workers may nevertheless be treated as employees by statute (statutory employees) for certain employment tax purposes if they fall within any one of the following four categories and meet the three conditions described under Social Security and Medicare taxes.
- The four categories:
  - A driver who distributes beverages (other than milk) or meat, vegetable, fruit, or bakery products; or who picks up and delivers laundry or dry cleaning, if the driver is your agent or is paid on commission.
  - A full-time life insurance sales agent whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.
  - An individual who works at home on materials or goods that you supply and that must be returned to you or to a person you name if you also furnish specifications for the work to be done.
  - A full-time traveling or city salesperson who works on your behalf and turns in orders to you from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed for you must be the salesperson's principal business activity.

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# Statutory Employee

- Withhold Social Security and Medicare taxes from the wages of statutory employees if all three of the following conditions apply.
  - The service contract states or implies that substantially all the services are to be performed personally by them.
  - They do not have a substantial investment in the equipment and property used to perform the services (other than an investment in transportation facilities).
  - The services are performed on a continuing basis for the same payer.
- **So a statutory employee is an independent contractor for whom social security and Medicare taxes must be withheld.**

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# Types of Income

- Direct cash/check/third party settlement payments
- Bartering
- Certain real estate rents
- Personal property rents
- Certain interest/dividend payments
- Certain cancelled debt income

- Restricted property
- Promissory notes
- Lost income payments
- Damages
- Kickbacks
- Reimbursement of previously deducted expenses

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## Cash/Check/3rd Party Settlement Payments

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- Money received
  - Cash
  - Checks
  - Debit cards
  - Credit card
  - Foreign currency

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## Bartering

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- Receipt of property is receipt of income!
  - Valued at FMV of the property as of date and time of receipt
  - Examples: cars, artwork, cryptocurrency, NFTs, whatever
- Receipt of services is receipt of income!
  - Valued at FMV of services received, usually agreed upon prior to exchange
  - Examples: legal fees, repair/cleaning, tax preparation

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# Certain Real Estate Rents

- Schedule C income if the taxpayer has an active rental activity, rather than passive!
  - Taxpayer engaged in the business of selling real estate to customers
  - Taxpayer rents property and provides services to the tenant
    - Like breakfast!
    - Hotels, motels, guest houses, AirbNb

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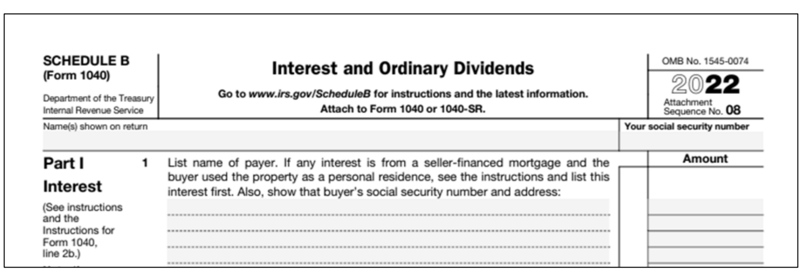
# Certain Interest/Dividend Payments

- Interest and dividend income is reported on Schedule C if:
  - Interest received on notes receivable accepted in the ordinary course of business.
  - Interest received on loans if taxpayer is in the business of lending money.
- For other taxpayers, interest and dividends go on Schedule B.



SCHEDULE B (Form 1040)
Department of the Treasury Internal Revenue Service

**Interest and Ordinary Dividends**

Go to *www.irs.gov/ScheduleB* for instructions and the latest information.
Attach to Form 1040 or 1040-SR.

OMB No. 1545-0074
2022
Attachment Sequence No. 08

Name(s) shown on return | Your social security number

**Part I Interest** (See instructions and the Instructions for Form 1040, line 2b.)

1 List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address:

Amount

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# Certain Cancelled Debt Income

- If a lender forgives/cancels a debt that was incurred in *business*, the forgiven/cancelled debt is reported as Schedule C income.
  - Exceptions:
    - A reduction in purchase price is not forgiven debt.
    - Income is not recognized to the extent that payment of the forgiven/cancelled debt would create a business deduction.
    - Bankruptcy/insolvency
    - Real property business indebtedness

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# Lost Income Payments

- Taxpayer may receive insurance payments for lost business income.
- This payment is reported on Schedule C even if the business is inactive when monies are received.


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# Kickbacks

- Kickback definition: *a payment made to someone who has facilitated a transaction or appointment, especially illicitly.*
- Kickbacks associated with a business are reported on Schedule C as income.
- But note that it may be a reduction of a related expense item, capital expenditure or COGS and then is reported as such.

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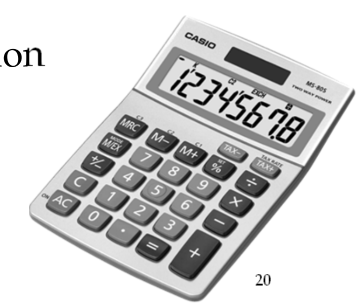
# Expense Reimbursements

- A recovery received for a bad debt or any other item deducted in a previous year is included in income to the extent the taxpayer received a tax benefit in that previous year.
- If all or part of the deduction in the earlier year did not reduce the taxpayer's tax liability, exclude that portion of the recovery amount received that did not reduce tax.
- Attach a statement to the 1040 showing the exclusion computation.

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# Returns & Allowances

- Report your sales returns and allowances as a positive number on line 2.
- A sales *return* is a cash or credit refund you gave to customers who returned defective, damaged, or unwanted products.
- A sales *allowance* is a reduction in the selling price of products, instead of a cash or credit refund.

**Part I Income**

| | | | |
|---|---|---|---|
| 1 | Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked ☐ | 1 | |
| 2 | Returns and allowances | 2 | |
| 3 | Subtract line 2 from line 1 | 3 | |
| 4 | Cost of goods sold (from line 42) | 4 | |
| 5 | **Gross profit.** Subtract line 4 from line 3 | 5 | |
| 6 | Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) | 6 | |
| 7 | **Gross income.** Add lines 5 and 6 | 7 | |

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# Other Income

- Line 6 is used to report business income not reported elsewhere, including:
  - Finance reserve income, scrap sales, recovered bad debts, prizes and awards related to the trade or business.
  - Interest (such as on notes and accounts receivable), state gasoline or fuel tax refunds
  - Any amount of credit for biofuel renewable diesel, and sustainable aviation fuel
  - Amounts received in the trade or business as shown on Form 1099-PATR.

**Part I Income**

| | | | |
|---|---|---|---|
| 1 | Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked ☐ | 1 | |
| 2 | Returns and allowances | 2 | |
| 3 | Subtract line 2 from line 1 | 3 | |
| 4 | Cost of goods sold (from line 42) | 4 | |
| 5 | **Gross profit.** Subtract line 4 from line 3 | 5 | |
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| 7 | **Gross income.** Add lines 5 and 6 | 7 | |

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# QUIZ

- True or false?
  1. Alice's interest income always goes on Schedule B, no exceptions.
  2. Reimbursements for Bob's past-year expense are taxable only to the extent that Bob got a tax benefit in the prior year.
  3. The kickback Charlie got isn't taxable because kickbacks are illegal.
  4. The interest Danny received on his business bank account (he sells books) is reported on Schedule C.
  5. Services that Edwin received as part of his barter club membership aren't taxable income.

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# Expenses

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# Startup Costs

- Expense incurred during the process of **creating** the business paid or incurred before the activity is open for business
  - Legal expenses for business creation
  - Investigation expenses
  - Borrowing costs
  - Insurance, license, permits
  - Website, information systems/software, POS software
  - Advertising, promotion, employee training
  - NOT startup? Training for a new job! Or deductible interest and taxes!

**Where do we deduct training for a new job?**

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# Start Up Cost Deduction Limitation

- By definition, start-up costs are capital expenditures, meaning they should be depreciated/amortized over 15 years
- An election can be made to take a certain amount as a deduction
- It's a deemed election
- Forgo the deemed election by capitalizing the start-up expenditures


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# Start Up Cost Deduction Limitation

- A taxpayer can elect to deduct up to $5,000 of business startup and $5,000 of organizational costs paid or incurred after October 22, 2004.
- The $5,000 deduction is reduced by the amount total startup or organizational costs exceed $50,000.
- Any remaining costs must be amortized.


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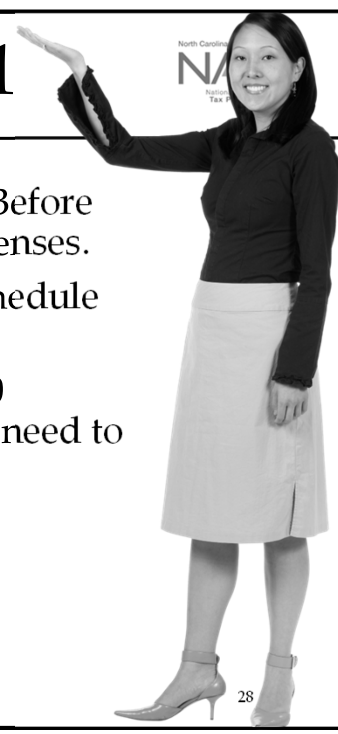
# Limitation Example #1



- Example #1: Barb opened a bakery on October 22. Before the business opened, she had $4,000 of startup expenses.
- Barb can deduct the full $4,000 on her first-year Schedule C as "Other Expenses.“
- Because her total expenses were less that the $5,000 allowable deduction for the first year, she does not need to worry about amortizing any of them.

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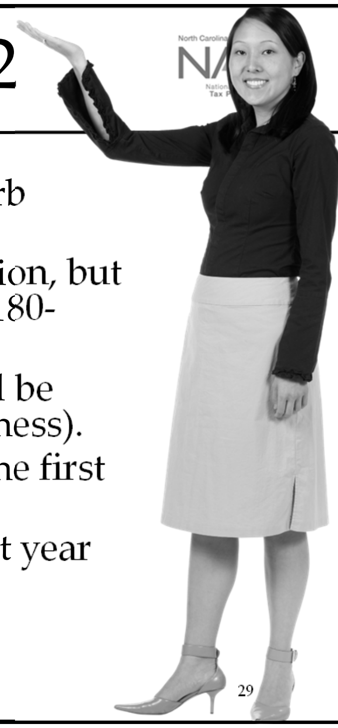
# Limitation Example #2



- Example #2: Assume the same facts, but instead Barb incurred $23,000 of start-up costs.
- She can claim $5,000 off the top as a current deduction, but the remaining $18,000 must be amortized over the 180-month period, which is a monthly amount of $100.
- Her amortization deduction for the first year would be $300 ($100 for each of the 3 months she was in business).
- This amount would be reported on Form 4562 for the first year and carried over to her Schedule C.
- Her total deduction for start-up expenses in the first year would be $5,300.

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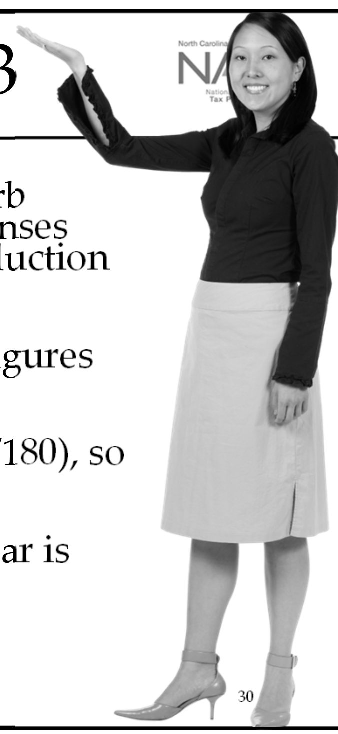
# Limitation Example #3



- Example #3: Assume the same facts, but instead Barb incurred $53,000 of start-up costs. Because the expenses exceed $50,000, she must reduce the initial year deduction by $1 for every $1 over $50,000.
- Thus, the $5,000 amount is reduced to $2,000. She figures the amortization on $51,000 ($53,000 - $2,000.)
- Her monthly amortization amount is $283 ($51,000/180), so her first year amortization deduction is $850.
- Her total start-up expense deduction for the first year is only $2,850.

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# Lines 8-17

Advertising: ads, website, promotions, business cards

Commissions and fees

Depletion for oil, gas, minerals or timber

Employee benefits

Mortgage interest

| | | |
|---|---|---|
| **Part II** | **Expenses.** Enter expenses for business use of your | |
| 8 | Advertising | 8 |
| 9 | Car and truck expenses (see instructions) | 9 |
| 10 | Commissions and fees | 10 |
| 11 | Contract labor (see instructions) | 11 |
| 12 | Depletion | 12 |
| 13 | Depreciation and section 179 expense deduction (not included in Part III) (see instructions) | 13 |
| 14 | Employee benefit programs (other than on line 19) | 14 |
| 15 | Insurance (other than health) | 15 |
| 16 | Interest (see instructions): | |
| a | Mortgage (paid to banks, etc.) | 16a |
| b | Other | 16b |
| 17 | Legal and professional services | 17 |

Car and truck: mileage or actual expenses

Contract labor not included in COGS

Depreciation, bonus, §179

Insurance

Other interest

Legal/professional fees

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# Lines 18-27a

Office expenses, postage, consumable supplies

Rent paid for vehicles, machinery and equipment

Repairs and maintenance for business property

Taxes and licenses

Utilities

| | | |
|---|---|---|
| 18 | Office expense (see instructions) | 18 |
| 19 | Pension and profit-sharing plans | 19 |
| 20 | Rent or lease (see instructions): | |
| a | Vehicles, machinery, and equipment | 20a |
| b | Other business property | 20b |
| 21 | Repairs and maintenance | 21 |
| 22 | Supplies (not included in Part III) | 22 |
| 23 | Taxes and licenses | 23 |
| 24 | Travel and meals: | |
| a | Travel | 24a |
| b | Deductible meals (see instructions) | 24b |
| 25 | Utilities | 25 |
| 26 | Wages (less employment credits) | 26 |
| 27a | Other expenses (from line 48) | 27a |
| b | **Reserved for future use** | 27b |

Pension and profit-sharing plans

Other rent, such as for buildings

Nonincidental materials and supplies actually consumed or sold during the year

Travel and meals

Wages

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# Line 27a, Other Expenses

- Include all ordinary and necessary business expenses not deducted elsewhere on Schedule C. List the type and amount of each expense separately in the space provided. Enter the total on lines 48 and 27a. Do not include the cost of business equipment or furniture; replacements or permanent improvements to property; or personal, living, and family expenses. Do not include charitable contributions. Also, you cannot deduct fines or penalties paid to a government for violating any law.
- Specifically: amortization, at-risk loss deduction, bad debts, startup costs, deduction for removing barriers to individuals with disabilities and the elderly, de minimis safe harbor for tangible property.

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# Travel Costs

- Business travel costs allowed when business requires travel away from tax home overnight!
  - Tax home is usually main place of business regardless of where family lives.
  - If no regular or main place of business, tax home may be place where you live.
  - If no regular or main place of business and no place where you regularly live, you are an itinerant and your tax home is wherever you work.

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# Travel Deduction Disallowed!

- No deduction for:
  - Travel expenses to and from personal residence if temporary location is expected to last more than one year
  - Attending foreign conventions unless directly related to business and reasonable argument exists for traveling to a foreign country
  - Entertainment, amusement, recreation
  - Family members unless they are employees and have a business reason to travel

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# Meals

- Meals must have business purpose
  - Sole proprietor/employee is present
  - Directly related or associated with conduct of business
  - Provided to current/potential business contact
  - May not include entertainment
  - Not lavish/extravagant
  - Restaurant meals paid/incurred in 2021 and 2022 were deducted 100% instead of 50% but that is GONE!

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# Meals Cheat Sheet

| Type of Expense | Deduction |
|---|---|
| Entertaining clients | 0% |
| Business meals with clients | 50% |
| Office snacks and meals | 50% |
| Company-wide party | 100% |
| Included in W-2 | 100% |

**What constitutes an acceptable receipt?**
For a receipt or voucher to be acceptable to the IRS, it must show:
•The date and amount of the expense
•Where the expense was incurred and the nature of the expense
**Restaurant receipts**
Receipts from restaurants must list the following:
•The restaurant's name and location
•The number of people served
•The date of and the amount of the expense
•An itemization of any additional nonfood or beverage expenses

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# Gift Deductions

- $25 per person max!
- Married receivers count as one person
- Married givers count as one person
- Partnership and partners count as one person

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# Rachel the Real Estate Agent

- Rachel spent $3,000 on gifts
- Here's her list:
  - Arnold Family $250 plant
  - Baxter Family $300 wine basket
  - Davidson Family $450 housewarming basket
  - Egbert Family $300 gift card for housecleaning
  - Etc., each of the 9 over $25!
- Total of 9 gifts

What do we tell her?

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# Rachel the Real Estate Agent

That's ridiculous. Next year, I'll just lump the gifts in with advertising.

**Your thoughts?**

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# Utilities

- Deduct utility expenses only for the trade or business. This is not where we deduct office in home utilities.
- If taxpayer used their home phone for business, do not deduct the base rate (including taxes) of the first phone line into the residence. But we can deduct any additional costs incurred for business that are **more** than the base rate of the first phone line.
- For example, if the taxpayer had a second line, we could deduct the business percentage of the charges for that line, including the base rate charges.

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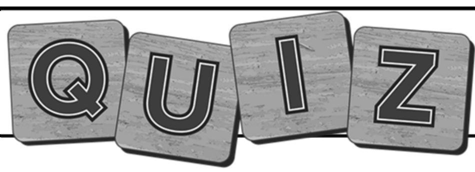


- Which client gets the deduction?
  - Frank spent $6000 for start-up costs and wants to deduct the full amount this year.
  - George took his wife and kids on a business trip; they're not employees but he thinks he should at least get to deduct everyone's airfare.
  - Harriet has no fixed place of work or residence, so she should get to deduct all travel and living expenses.
  - Irene takes her clients to a baseball game and pays for food; since a meal is involved, she wants to deduct the full cost of the tickets and the food.

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# Cost of Goods Sold

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# COGS

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Schedule C (Form 1040) 2021 — Page 2

**Part III Cost of Goods Sold** (see instructions)

33 Method(s) used to value closing inventory: a ☐ Cost b ☐ Lower of cost or market c ☐ Other (attach explanation)

34 Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation . . . ☐ Yes ☐ No

| | | | |
|---|---|---|---|
| 35 | Inventory at beginning of year. If different from last year's closing inventory, attach explanation | 35 | |
| 36 | Purchases less cost of items withdrawn for personal use | 36 | |
| 37 | Cost of labor. Do not include any amounts paid to yourself | 37 | |
| 38 | Materials and supplies | 38 | |
| 39 | Other costs | 39 | |
| 40 | Add lines 35 through 39 | 40 | |
| 41 | Inventory at end of year | 41 | |
| 42 | **Cost of goods sold.** Subtract line 41 from line 40. Enter the result here and on line 4 | 42 | |

**Income**

| | | | | | |
|---|---|---|---|---|---|
| 1a | Gross receipts or sales | 1a | | | |
| b | Returns and allowances | 1b | | | |
| c | Balance. Subtract line 1b from line 1a | | | 1c | |
| 2 | Cost of goods sold (attach Form 1125-A) | | | 2 | |
| 3 | Gross profit. Subtract line 2 from line 1c | | | 3 | |
| 4 | Net gain (loss) from Form 4797, line 17 (attach Form 4797) | | | 4 | |
| 5 | Other income (loss) (see instructions—attach statement) | | | 5 | |
| 6 | **Total income (loss).** Add lines 3 through 5 | | | 6 | |

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## Pub 534, *Tax Guide for Small Businesses*

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- If you are a **small business taxpayer**, you can choose not to keep an inventory, but you must still use a method of accounting for inventory that clearly reflects income.
- If you choose not to keep an inventory, you won't be treated as failing to clearly reflect income if your method of accounting for inventory treats inventory as **non-incidental material or supplies**, or conforms to your financial accounting treatment of inventories.
- If, however, you choose to keep an inventory, you must generally use an accrual method of accounting and value the inventory each year to determine your cost of goods sold in Part III of Schedule C.
- You qualify as a **small business taxpayer** if you have average annual gross receipts of $27 million or less for the 3 prior tax years, and are not a tax shelter (as defined in section 448(d)(3)).

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## Non-Incidental Materials or Supplies

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- **Line 22 on Schedule C:** In most cases, the taxpayer can deduct the cost of materials and supplies only to the extent they were actually consumed and used in the business during the tax year.
- However, if the taxpayer had incidental materials and supplies on hand for which the taxpayer kept no inventories or records of use, the taxpayer can deduct the cost of those actually purchased during the tax year, provided that method clearly reflects income.

| | | | |
|---|---|---|---|
| 18 | Office expense (see instructions) . | 18 | |
| 19 | Pension and profit-sharing plans . | 19 | |
| 20 | Rent or lease (see instructions): | | |
| a | Vehicles, machinery, and equipment | 20a | |
| b | Other business property . . . | 20b | |
| 21 | Repairs and maintenance . . . | 21 | |
| 22 | Supplies (not included in Part III) . | 22 | |

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# Vehicle Deductions

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# Business Use of Vehicle

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- 100% business use only if there is no personal or commuting mileage!
  - Rare but not impossible
  - Car is parked at business location and has no personal use
  - Typically, a specialty vehicle such as a large truck or van
- Otherwise, mixed use!


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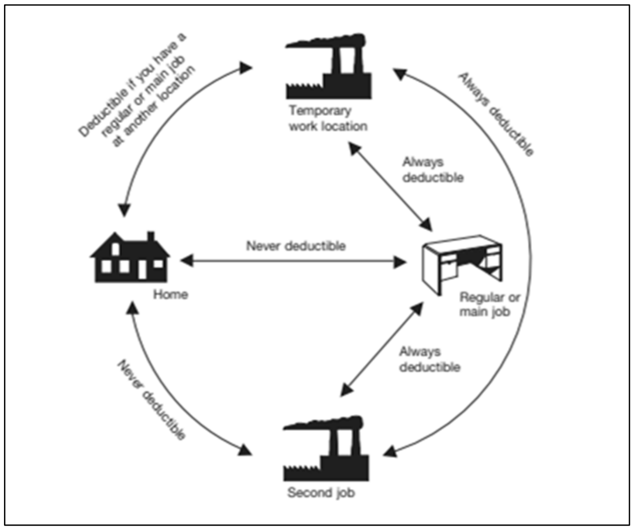
# Deductible vs. Nondeductible Mileage

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# Nice Try, But No

- Performing work duties while commuting to your office does not change the fact that the miles are nondeductible commuting miles.
- Putting your business name on the car doesn't make commuting mileage into business mileage.
- Talking to a client on the phone on the way to work doesn't make it business mileage.
- Stopping at the bank on your way to the grocery store in order to deposit a business check does not make it business mileage.

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# Deduction Options

- Actual Method
  - A percentage of all vehicle expenses are deductible
    - Repairs, maintenance, car washes, fuel
    - Interest on vehicle loan/lease payments, vehicle license tax
    - 100% of business parking fees and tolls
- Standard Method
  - 58.5 cents per mile 1/1/2022 – 6/30/2022
  - 62.5 cents per mile 6/30/2022 – 12/31/2022
  - 65.5 cents per mile for 2023
  - Also deduct business % of car loan interest, vehicle license tax
  - Also deduct business-related parking and tolls

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# Documentation!

- Contemporaneous record
  - Written account book, diary, log
  - Phone app
  - Purpose of business trip, including client's name, training event, whatever is appropriate
  - Credit card bills don't count!
  - Records created later don't count!

MileIQ

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# Actual Method Required If..

- The vehicle has been depreciated using a method other than straight-line (SL), such as modified accelerated cost recovery system (MACRS) or accelerated cost recovery system (ACRS)
- The taxpayer claimed a §179 deduction for the vehicle
- The taxpayer claimed bonus depreciation for the vehicle

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# Switching Back and Forth

- Switching is allowed **IF** the taxpayer has chosen the standard mileage rate in Year 1.
- They may then switch to the actual method in a future year.
- Not clear if more switching is allowed after that.
- For that future year, basis must be adjusted by the depreciation component of the standard mileage rate of prior years.
- Why? Because the standard mileage rate has a depreciation component!

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# Lease Payments

- Sole proprietors can treat leased vehicles much like purchased vehicles.
- Use either the standard mileage rate or actual expenses to calculate the deduction.
- Deduct the business portion of the lease payment, calculated as the % of the overall mileage that is business mileage.
- Lease inclusion amount reduces the lease deduction, based on the FMV of the vehicle on the first day of the lease.

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# Tommy’s Vehicle Deduction

- Tommy uses his car for business. In 2022, he put a total of 20,000 miles on the car. Of these, 2,000 were for business.
- He paid $1500 of interest on the car loan, and paid vehicle license tax of $150.
- We calculate his vehicle deduction using the standard method as follows:
  - Business mileage: 2,000 x average of $.605/mile = $1,210
  - Interest expense $1,500 x 10% = $150
  - Vehicle license tax $150 x 10% = $15
  - **Total $1,120 + $150 + $15 = $1,285**

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# Don't Get Carried Away

Arizona Chapter 35 Years

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# Be Audit-Ready

- Schedule C is a highly auditable form!
- IRS Rule 142(a) states that the IRS Commissioner's notice of deficiency is presumed correct, and the burden of proof rests on the taxpayer
- The burden of proof may shift to the Commissioner if the taxpayer introduces creditable evidence with respect to a relevant factual issue if….
- (1) taxpayer complied with the requirements to substantiate any item, and
- (2) taxpayer maintained all records required, and
- (3) taxpayer cooperated with reasonable requests by the IRS for witnesses, information, documents, meetings and interviews

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# What About the Cohan Rule?

- What about the Cohan Rule?
- Result of Cohan v. Commissioner (1930), the Cohan rule is that if a taxpayer claims a deduction but cannot fully substantiate the expense, the court **MAY** approximate the allowable amount "bearing heavily if it so chooses upon the taxpayer whose inexactitude is of his own making"
- Key word: **MAY!!!** So don't rely on this!

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# Taxpayer v. Comm'r T.C. Memo 2023-xx

- Taxpayer operated a sole proprietorship
- In 2017, he filed a joint return reporting gross receipts of $52,807 and COGS of $52,110, resulting in a net profit of $697.
- The IRS got curious and audited the return.
- Lumped under COGS were expenses such as rent, home office deductions, meals, travel, entertainment, licenses, and so on.
- The taxpayer was able to provide 200 pages of documentation, which included a P&L, depreciation schedule, a general ledger with entries for personal and business expenditures, and a diary logging business travel.

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# Taxpayer v. Comm’r T.C. Memo 2023-xx

- Sadly, the diary that recorded business travel did not list the time, place and business purpose of the travel as is required.
- Items listed were vague in nature and did not indicate how the meetings related to the business.
- The IRS disallowed all travel expenses.
- Home office expenses totaled $13,519, which taxpayer claimed for FOUR rooms out of TEN in his home.
- The taxpayer also claimed rental expenses for an office in New York City, as well as membership at the Yale Club, also classified as rent.
- These expenses were all disallowed.

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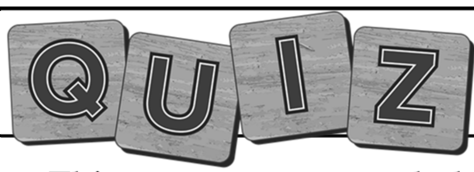


- This taxpayer was probably a…
  a. Doctor
  b. Real estate agent
  c. CPA
  d. Attorney


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# Questions?

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