2022 Guidelines for Schedule C
Profit or Loss from Business (Sole Proprietorship)

Taxpayers may engage in full or part time activities in a trade or business as a sole proprietor or independent contractor. An activity qualifies as a business if the taxpayer's primary purpose for engaging in the activity is for income or profit and he or she is involved in the activity with continuity and regularity. When the activities do not rise to the level of a trade or business, e.g., if the activity is not engaged in for profit (such as a hobby), special rules[1] apply and the return is out of scope for Tax-Aide.

The facts and circumstances of the taxpayer's business will determine how the guidelines below apply to the taxpayer's situation. Although the taxpayer has full responsibility for the accuracy of the information in the return and for making facts and circumstances decisions (such as whether an expense is ordinary and necessary, or whether the conduct of the business is continual and regular), the Counselor should exercise due diligence by informing the taxpayer of the guidelines for making decisions. The Counselor should decline to complete the return if he or she concludes that the claimed income and/or expenses are not consistent with the nature of the taxpayer's business or the taxpayer fails to establish good faith in their representations.

Scope

Business income and expenses associated with these activities are reported on Schedule C and are in scope for Tax-Aide if the taxpayer meets ALL of the following conditions:

- Uses the cash method of accounting for the business
- Does not have a net loss from the business
- Does not have any employees or contract labor (individuals not treated as employees)
- Does not have prior year unallowed passive activity losses from the business
- Does not have a prior year loss with a carry-forward Qualified Business Income (QBI) loss
- Is not required to file Form 4562 – Depreciation and Amortization
- Does not deduct expenses for business use of a home
- Has no inventory at any time during the year. Since 2018, cash-basis taxpayers can expense 100% of their purchases of goods when paid. If there is an opening inventory, taxpayer needs to go to a professional preparer to file the required change of accounting form with their return.
- Claims mileage at the standard rate rather than actual cost method for their owned, leased, or rented[2] vehicle (actual costs include depreciation, lease or rental cost, maintenance, repair, fuel, insurance, etc.)
- Has no more than $35,000 of business expenses including goods purchased for resale or production
- Has no out-of-scope expenses or any transactions involving bartering or digital assets (virtual currencies)

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[1] Income is reported as other income and no deductions are allowed (all 2% miscellaneous itemized deductions are suspended for 2018–2025 for federal tax purposes – state law may differ).

[2] Does not apply to a vehicle rented during out-of-town business travel the business portion of which may be deductible.

The taxpayer should have records to support their income and expenses or be able to reasonably reconstruct income and expense records. If the Counselor concludes that the taxpayer is providing inaccurate, incomplete or inconsistent information (i.e. cash income in round numbers, very few or no expenses where expenses would be expected, or few or no records), the Counselor should decline to prepare the return. The Schedule C should provide an accurate picture of the taxpayer's income and expenses – not just those the taxpayer selects in order to control the result. If the taxpayer has more than one business, report each on a separate Schedule C.

Jointly Run Business

If the taxpayer and spouse own the business 50/50 and are filing jointly, enter all the information on a single Schedule C. In TaxSlayer Schedule C > Questions About the Operation of Your Business, check the box that indicates this is a qualified joint venture and TaxSlayer will split the Schedule C between the two spouses and compute the self-employment tax accordingly.

If the ownership is other than 50/50 or TP and Spouse are not filing jointly, a Schedule C must be prepared for each person with the income and expenses pro-rated based on the ownership.

Form of Doing Business

An individual may have set up a limited liability company (LLC) or other type of legal entity to limit their business risk. Refer such individuals to a professional tax preparer.

State Issues

Many states have enacted laws that reach out to tax individuals who are not resident in their state. When a taxpayer has receipts from activities outside their state, there may be a filing requirement in such other state. Some states have tax laws that significantly vary from federal tax law, such as treating a business owner as an employee for state purposes.

Check with your Local Coordinator whether a taxpayer with state tax issues should be referred to a professional tax preparer.

Income

All self-employment income must be reported on Schedule C. The information may come from Forms 1099-NEC (Non-employee Compensation); Forms 1099-MISC box 2 (Royalties), box 3 (Other Income) or box 6 (care providers); Forms 1099-K (Merchant Card and Third Party Payments); and from taxpayer records of business receipts not reported on a 1099 (including tips). Note that it is not unusual for a company to issue multiple Forms 1099. For example, rideshare companies issue both Forms 1099-NEC and 1099-K.

Also, note that receipt of Form 1099-K or 1099-NEC may or may not represent a business activity. Individuals who receive Form 1099-K for personal transactions should contact the reporting entity or adequately identify personal transactions so they are not reported on Form 1099-K in the future.

For more guidance on Form 1099-K, see the NTTC Form 1099-K Payments tax law paper on the Portal.

Expenses

All allowable **and** documented expenses must be reported on Schedule C. Refer to Pub 4491 NTTC Modified TY22 for a discussion of business expenses. This paper expands some of those expense items. If there are deductible expenses that are out of scope for Tax-Aide as described in the Scope Manual, the return is out of scope for Tax-Aide. The tax return may not be prepared and taxpayer must be referred to a professional tax preparer. There is no option to disregard allowable and documented expenses, even if claiming all expenses results in a net loss.

Goods sold: Starting with tax year 2018, the cost of goods purchased for resale or as raw materials can be expensed in the year paid as "other expenses" in TaxSlayer[3]. New cash-basis businesses can adopt this method of accounting. Businesses with opening inventory should file for an automatic change of method of accounting, which makes the year-of-change return out of scope. The method of accounting for inventories should be set to "not applicable" in Schedule C > Questions About the Operation of Your Business screen in TaxSlayer. Supplies are also deductible in the year they are paid for, not when the items are used or consumed in the business, and are listed in General or Other Expenses in TaxSlayer.

Telephones: The cost of basic local telephone service for the first telephone line in the home is not deductible. However, separate charges for business long distance phone calls on that line, as well as the cost of a second line into the home or cellphone that is used for business, are deductible business expenses. If the taxpayer has a flat-rate phone service (landline or cellphone) that includes unlimited phone calls, he or she may deduct the prorated business-related portion of that expense even if that is his or her only phone service. Note, the taxpayer must determine the portion a bundle price (e.g., internet, TV and phone) which is for the phone service and then the portion of that expense that is business related. As with all business expenses, the taxpayer should be advised of the need to maintain records for the business portion of phone deductions.

Gig Drivers and Others Claiming Business Miles: Taxpayers claiming business miles, including for-hire rideshare (Uber, Lyft, etc.), delivery (Postmates, DoorDash, GrubHub, etc.), and other drivers, who are otherwise in-scope can use the standard mileage method (the actual expense method is out of scope). Additionally, taxpayers must determine the expenses that can be claimed in addition to the standard mileage method using any reasonable method, such as relative mileage, to determine the business portion. Examples of expenses, the **business portion of which** can be claimed in addition to the standard mileage rate amount, include (this list is illustrative, not limiting):

- Interest on a car loan
- State and local personal property tax on the car
- Parking, airport, and toll fees
- Cell phone and cellular service
- Dash camera
- Ride-sharing insurance, commissions or fees (not requiring Form 1099 to be filed)
- Passenger amenities (beverages, snacks, phone chargers, etc.)
- Roadside assistance plans
- Mileage tracking software

[3] Pub 334, page 15

Car washes are not listed above as normal car washes are included in the standard mileage rate. Extraordinary washes can be added to the standard mileage rate, e.g. after a rider soils the car and the driver was not reimbursed in full or the reimbursement is included in their 1099.

As with all business owners, drivers should keep detailed records of their miles driven and all business expenses. For most in-scope drivers, the mileage from the taxpayer's home to the first pick-up and home after the last drop-off is considered commuting mileage by the IRS and is not deductible because they do not have a home office. There may be circumstances where this is not applicable (e.g., going outside their metropolitan zone) so it is up to the taxpayer to compute their deductible business miles.

Home Office Deductions: If a taxpayer believes he or she can claim a home office deduction (using either the simplified method or the standard method) and due diligence confirms he or she likely meets the exclusive use and regular use requirements (see IRS Pub 587), the return is out of scope for Tax-Aide and the taxpayer must be referred to a professional tax preparer. If the taxpayer has no intent to claim this deduction, the return remains in scope so long as no undue benefit results, such as increasing the amount of EIC.

Self-Employed Health Insurance (SEHI) Deduction: Sole proprietors can deduct the amount paid for health or long-term care insurance for the business owner, spouse, dependents and any child who was under age 27 at the end of the tax year, even if the child isn't a dependent. The sole proprietor must not be eligible for employer-subsidized coverage from any current employer: his or her own, the spouse's, a dependent's, or a child's. Eligibility is tested on a monthly basis. For example, if eligible for employer-subsidized coverage in May, then not eligible for the self-employment health insurance deduction for May regardless of when the May premium was actually paid (this is an exception to the cash-basis rules).

Health insurance that qualifies includes Medicare, retiree, or any private insurance for medical, vision, dental, or special policies (such as a cancer policy). If the Public Safety Officer exclusion applies, the eligible premiums for SEHI are those in excess of the PSO exclusion.

Premiums paid on qualified Long-Term Care (LTC) insurance contracts are subject to the same age-based dollar limitations as for Schedule A. The requirement that the sole proprietor is not eligible for subsidized coverage is tested separately for long-term care.

In all cases, the premiums must have been paid by the sole proprietor or the spouse if filing MFJ. For example, Medicare deducted from the spouse's Social Security benefits can be included in the SEHI deduction.

The SEHI deduction is entered as *Health Insurance* on the Schedule C > General Expenses entry page (do not use the link for adjustments to gross income). If there is more than one business (and therefore more than one Schedule C), allocate the allowable health insurance premiums among the Schedule Cs. Alternatively, health care premiums could be included as an itemized expense on Schedule A, but an adjustment to gross income has multiple benefits for the taxpayer. Care should be taken to enter the expense in one place only to avoid duplication. If the total health insurance exceeds the SEHI limit, TaxSlayer automatically carries the excess to Schedule A.

The SEHI deduction is out of scope for health insurance purchased through the Marketplace if the taxpayer is entitled to Premium Tax Credits (PTC). This scope limitation is due to the iterative calculations typically required to settle on the AGI and PTC. Simply ignoring this adjustment can result in a significant disadvantage for the taxpayer since the AGI impacts so many other aspects of the tax return. The taxpayer should be referred to a professional tax preparer. This prohibition does not apply if the business owner can use other health insurance (such as LTC or Medicare for the spouse) that is equal to or greater than the allowable SEHI deduction limit.

SEHI versus Schedule A Deduction: The SEHI deduction will result in the lowest federal AGI for a taxpayer who does not itemize deductions. If the taxpayer does itemize, compare the results for the federal and state returns with the SEHI deduction (and less Schedule A medical expenses) with the return without the SEHI deduction (and all medical expenses on Schedule A). **Caution**: be careful to not double count or to omit medical expenses when changing from one scenario to the other. Make this comparison after all other sections of the federal return are complete (but review other aspects of the return to confirm that no further analysis or change is needed). State tax law may impact the overall decision on these deductions and Counselors should compare the federal plus state impacts to determine which is better.

Caution: Medicare Part B and Part D premiums will be higher if the modified AGI from 2 years prior is greater than a certain amount which is adjusted for inflation. [See Medicare premiums]

Summary

Counselors should consider the combined federal and state results of alternatives to determine the best result for the taxpayer. For example, which is better: claiming health insurance premiums as SEHI or itemized on Schedule A. Fortunately, what-if testing is relatively straightforward using TaxSlayer.

Expenses as noted above must be allowable and documented. Counselors may accept the taxpayer’s statement that there are records to support expenses instead of seeing the actual records. If a taxpayer declines to include reasonable and ordinary expenses because they aren’t documented; that is, the taxpayer has no records to substantiate the expenses **and** the taxpayer will be entitled to an earned income tax credit, the taxpayer must attempt to construct the records using bank and credit card statements, his or her personal calendar, etc. or the Counselor should decline to prepare the return.

Examples

Example 1: A taxpayer, engaged in a direct-sale business such as Amway, Avon, Mary Kay or The Pampered Chef, orders products. These can be on a buy-sell, commission or consignment basis. Starting with tax year 2018, all can be in scope (assuming no opening inventory) and goods purchased for resale are immediately expensed as Other Expenses. For years prior to 2018, only consigned-good direct sellers are in scope. In all cases, taxpayers should not claim an expense for any item they consume or use personally. Only items used in the business can be claimed on the return.

Example 2: David, a full-time college student who lives at home, also drives part-time three days a week after school as an independent contractor for Uber. He uses an app to keep track of all mileage driven, parking, tolls, and other business-related expenses. His Uber-related expenses, including mileage at the standard per mile rate, are deductible expenses. While the mileage to school is not deductible, all mileage once he leaves school when driving for Uber other than the mileage from his last customer to home is considered business mileage.

Example 3: Luna drives as an independent contractor for Uber. She leases a vehicle from Uber and keeps a log of all mileage driven, parking and tolls. Her Uber-related parking, tolls and mileage at the standard per mile rate are deductible expenses. If she decides to deduct her lease expenses, her return is out of scope for Tax-Aide.

Example 4: Alva has no land-line telephone service, just a cellphone for both personal and business use with unlimited calls and text. She determines that 10% is business use and decides to claim that portion as her deduction.

Example 5: Jeff has no land-line telephone service and has a cellphone for personal use. He purchased a second cellphone for $650 with a new number for business use; it has negligible personal use. The cost of the second cellphone and service are deductible expenses.

Example 6: Harini is a working mother of a college student. To make ends meet she uses Airbnb to rent out her son's room when he is at school (more than 14 days). Normally, rentals would be reported on Schedule E. But in the case of short-term rentals (such as Airbnb), the services provided may be more than nominal and the activity may be properly classified as a business. Since Harini is required to reduce her basis in her property by the full amount of depreciation that she could claim, her return is out of scope for Tax-Aide.

Example 7: Bob sews drapes on a made-to-order basis. He buys the fabric selected by the client and delivers and installs the finished drapes. The fabric is a raw material for the finished product and is deducted as materials for resale in the Schedule C > Other Expenses section of TaxSlayer.

Example 8: Felix is a handyman and can paint, patch or fix almost anything. He has a complement of tools that include items such as portable saws, paint sprayers and nail guns. He purchased expensive tools this year that are over the de minimis amount. Felix must claim a depreciation deduction or make an immediate expense election for them. Once the Counselor learns that Felix has purchased these tools, the return becomes out of scope as Form 4562 is out of scope in its entirety.

Example 9: Ariel is retired and enjoys painting landscapes. She views her creations as an artistic exercise done for pleasure, but occasionally sells some of her paintings. A Schedule C would not be prepared as this is not an activity that qualifies as a business since Ariel’s primary purpose for engaging in the activity is not for income or profit. Her return is out of scope for Tax-Aide.