CALIFORNIA CONTINUING EDUCATION, INC

PRESENTS

TAX RECORDS

by

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Premise: “The Official Start and Stop” of “Being in Business” needs to be reflected in the records. All of the investigating should be done BEFORE business is started. But once business starts, a series of record keeping requirements arises. When going out of business, record keeping can somewhat insulate the business owner from later inquiry, including an audit.

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TAX RECORDS

Table of Contents

I. Types of Earning Activities

You do not have to carry on regular full-time business activities to be self-employed. Having a part-time business in addition to your regular job or business may be self-employment.

Independent contractor. The general rule is that an individual is an independent contractor if the person paying for the work has the right to control or to direct only the result of the work and not how it will be done. The earnings of a person who is working as an independent contractor are subject to self-employment tax.

Statutory employee. A statutory employee has a check-mark in box 13 of his or her Form W-2, Wage and Tax Statement. Statutory employees use Schedule C or C-EZ to report their wages and expenses.

A limited liability company (LLC) is an entity formed under state law by filing articles of organization. Generally, for income tax purposes, a single-member LLC is disregarded as an entity separate from its owner and reports its income and deductions on its owner's federal income tax return using Schedule C or C-EZ.

Business owned and operated by spouses. If you and your spouse jointly (separately) own and operate an unincorporated business and share in the profits and losses, you are partners in a partnership, whether or not you have a formal partnership agreement. Form 1065, U.S. Return of Partnership Income is required.

An exception exists for community income. The only states with community property laws are AZ, CA, ID, LA, NV, NM, TX, WA, and WI. If community property spouses own an unincorporated business as community property under the community property laws of a state, foreign country, or U.S. possession, you can treat the business either as a sole proprietorship or a partner-ship.

Another exception is a Qualified joint venture. A qualified joint venture is a joint venture that conducts a trade or business where (1) the only members of the joint venture are a married couple who file a joint return, (2) both spouses materially participate in the trade or business, and (3) both spouses elect not to be treated as a partnership. A qualified joint venture is a joint venture that conducts a trade or business where (1) the only members of the joint venture are a married couple who file a joint return, (2) both spouses materially participate in the trade or business, and (3) both spouses elect not to be treated as a partnership.

You have to file an income tax return for 2016 if your net earnings from self-employment were $400 or more. (Filing a return is always advised as it sets the record for your income especially if the IRS contests your reported income via audit.) Filing a return will also eliminate much of the need to keep records beyond 7 years.

Although you may be able to file your tax returns electronically using an IRS e-file option, it is always recommended to file returns by paper so that you can include copies of any exhibits and verifications, and make any explanations; so long as the delivery method to IRS can absolutely prove that the return was complete and filed on time. Suggestions include a cover letter the reflects the contents of the transmission to IRS, along with receipts that show delivery and preferably a return post card. Each piece of evidence can be used to combat a charge of late or non-filing.

Each taxpayer should adjust a combination of their withholdings and estimated tax payments to result in a positive, smallest magnitude refund (shoot for $5 for example).

Every taxpayer should know that anyone hired to prepare and/or file a tax return on a taxpayer's behalf has NO PRIVILEGE and can be forced by the government to testify against such taxpayer. Also, government can charge conspiracy against a taxpayer and a preparer that act in concert to defraud the government with a tax return.

Every taxpayer should know that anyone with whom they share responsibility as to a tax liability hired to prepare and/or file a tax return on a taxpayer's behalf has NO PRIVILEGE and can be forced by the government to testify against such taxpayer. In addition, the government can charge conspiracy against two taxpayers that have shared responsibility as to a tax return.

Last known address is an extremely important data item that should be verified each time the IRS is contacted. Submitting your paper return by mail will enable you to identify your address and to use the proof of mailing and return as further evidence that you have re-verified your last known address to the IRS. If IRS attempts to make some contact and if the taxpayer has not maintained their last known address, acts taken by the IRS against the taxpayer may not be able to be reversed.

It is also highly recommended that every taxpayer has their refund check mailed. First, it is a further verification that IRS has the taxpayer's proper address. Second, it prevents having to rely upon entry of the bank account codes. In some cases, preparers can put a wrong destination account number in order to steal the taxpayer's refund. In other cases, an error in bank account can result in a stranger receiving a taxpayer's refund and thinking it was a bank error or thinking that the IRS was giving them a refund to be spent as soon as possible. It is significantly difficult to try and get the money back from the taxpayer that wrongly received it.

IRS touts its personal e-filing system for taxpayers making less than $64,000 annually. Electronic filing is notorious for rejecting the filing in the event that there is a mismatch in either data or the handshake between the IRS computer and taxpayer. I get stories about taxpayers that file online only to receive a rejection by email anywhere between a few hours and a few minutes. IRS states in its materials "You receive an electronic acknowledgment within 48 hours that the IRS has accepted your return for processing." So, if you file at the last minute and get a notice 2 days later that your submission is rejected, you will be both late and not filed and no extension. You will get a penalty because no extension was filed. Conversely, if you file a paper return with proof of mailing, IRS has to accept the return as a properly filed return. If IRS is unhappy later, they can always

An independent contractor is someone who is self-employed. You do not generally have to withhold or pay any taxes on payments made to an independent contractor.

II. Types of Tax Returns

(A) Excise Taxes List
This section identifies some of the excise taxes you may have to pay and the forms you have to file if you do any of the following: (1) Manufacture or sell certain products, (2) Operate certain kinds of businesses. (3) Use various kinds of equipment, facilities, or products. (4) Receive payment for certain services. (5) Environmental taxes on the sale or use of ozone-depleting chemicals and imported products containing or manufactured with these chemicals, (6) Communications and air transportation taxes, (7) Fuel taxes, (8) Tax on the first retail sale of heavy trucks, trailers, and tractors, (9) Manufacturers taxes on the sale or use of a variety of different articles and (10) Tax on indoor tanning services, and (11) a federal excise tax on the use of certain trucks, truck tractors, and buses on public high-ways that have a taxable gross weight of 55,000 pounds or more, to name but a few of the major categories.

(B) Information Returns
If you make or receive payments in your business, you may have to report them to the IRS on information returns. The IRS compares the payments shown on the information returns with each person's income tax return to see if the payments were included in income. You must give a copy of each information return you are required to file to the recipient or payer. In addition to the forms described below, you may have to use other returns to report certain kinds of payments or transactions. For more details on in-formation returns and when you have to file them, see the General Instructions for Certain Information Returns. Examples include (1) miscellaneous payments you make in business (1099's), (2) payments of $600 or more for services performed for your business by people not treated as your employees, such as fees to subcontractors, attorneys, accountants, or directors, (3) rent payments of $600 or more, other than rents paid to real estate agents, (4) prizes and awards of $600 or more that are not for services, such as winnings on TV or radio shows, Royalty payments of $10 or more, (5) payments to certain crew members by operators of fishing boats, (6) report of sales of $5,000 or more of consumer goods to a person for resale anywhere other than in a permanent retail establishment, (7) Form W-2, Wage and Tax Statement, to report payments to your employees, such as wages, tips, and other compensation, withheld income, social security, and Medicare taxes, to name a few.

(C) Penalties.
The law provides for the following penalties if you do not file certain information returns. Failure to file a required information return could provide an element of proof in a prosecution for tax evasion. Failure includes both (a) failure to file information returns by the due date, and (b) failure to report correct information. Waiver of penalties will generally not apply unless you can show that the failure was due to (a) reasonable cause and (b) not willful neglect.

(D) Cash Transaction Reporting
Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business, is required if more than $10,000 in cash is received in one transaction, or two or more related transactions. Cash includes U.S. and foreign coin and currency. It also includes certain money instruments such as cashier's and traveler's checks and money orders. Cash does not include a check drawn on an individual's personal account (personal check). There are civil and criminal penalties, including up to 5 years in prison, for not filing Form 8300, or filing (or causing the filing of) a false or fraudulent Form 8300, or structuring a transaction in a way to evade reporting requirements.

(E) Going Out of Business Checklists

I have found that the most dangerous factor in not continuing a business is the failure to keep business records for the years following the close of business. After all, a defeat in business is usually something you want to cast out, get rid of, and remove all indicia of its existence. Don't fall prey to this "erase the board" syndrome. You keep tax records for your defunct business better than you kept for yourself.

You should keep a record that includes some formalization documents that shows the time at which it was decided to give up the business, as well as a plan for going out of business (checklists) and some documentation of what was done. I talk to people periodically that are hit with an audit for a business that the taxpayer has not touched for 2-3 years. The key is the ability to prove the date when business ceased. The tax agencies typically won't believe a bare statement that there has been no business conducted for 1, 2, 3, or 4 years.

Some forms can help establish quitting business, but more is needed in order to overwhelmingly convince an auditor on the timing if cessation of business. The Thomson publications that appear in the "Quickfinder" series generally urge a 7 year records retention period, for nearly everything. Even this does not help if the records are not created in the beginning. Save all expense receipts for seven years.

(F) Some important & available forms
If things are done properly, forms can include: (1)(a) Income tax: File Schedule C or C-EZ with your Form 1040 for the year during which business terminates, and designate some indication that it is final as to that business.
(b)File Form 4797 with Form 1040 for each year in which a sale or exchange property used in the business or in which the business use of certain section 179 or listed property drops below 50%.
(c) File Form 8594 with your Form 1040 if you sold your business.
(d) Form 8275 is a Disclosure Statement, essentially a free form narrative + some spaces to identify statutes and regulations to assist IRS in understanding the import of the disclosure from the taxpayer.

(2) Self-employment tax: File Schedule SE with Form 1040 & make some notation of finality.

(3)(a) Employment taxes: File Form 941 (or Form 944) for the calendar quarter in which you make final wage payments. Note. Do not forget to check the box and enter the date final wages were paid on line 15 of Form 941 or line 14 of Form 944, and some other indication of finality.
(b) File Form 940 for the calendar year in which final wages were paid. Note. Do not forget to check box d, Final: Business closed or stopped paying wages, under Type of Return.

(4)(a) Information returns: Provide Forms W-2 to your employees for the calendar year in which you make final wage payments & File Form W-3 relating to Forms W-2.
(b) Provide Forms 1099-MISC to each person to whom you have paid at least $600 for services (including parts and materials) during the calendar year in which you go out of business & File Form 1096 to file Forms 1099-MISC.

(5) Save and memorialize Form 1128, Application To Adopt, Change, or Retain a Tax Year, to request IRS approval to change your tax year. This will help prove up the cessation of business in a particular year.

(6) All state income tax forms relating to (1)-(6) above should indicate fact and timing of cessation of business.

(7) Sale of a business. Although the sale of a business usually is not a sale of one asset, there should be a global sales document that marks the date of sale, as well as any responsibility for (a) recording title changes, (b) undertaking lease obligations, (c) paying taxes and fees, (d) transfer of asset book value & depreciation schedules and (e) a checklist of steps necessary to declare finality of the transaction.

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