

# THE OFFICE OF PROFESSIONAL RESPONSIBILITY

Standard Bearer for  
Integrity in Tax Practice

Karen L. Hawkins, Director

## The Statute & Regulations

- 31 U.S.C. §330 (1884)
- 31 C.F.R. Part 10 (cir. 1886)
- Authorizes regulation of representatives of persons before the Department of the Treasury

## “Fitness” to Practice

- good character
- good reputation
- necessary qualifications to enable the representative to provide valuable service to the client
- competency to advise and assist persons in presenting their cases

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## Circular 230

- Online at [www.irs.gov/pub/irs-pdf/pcir230.pdf](http://www.irs.gov/pub/irs-pdf/pcir230.pdf)
- Substantial revisions effective August 2, 2011
- NPRM – Additional Revisions Proposed – Final Regs pending

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## Calendar Year 2012 Discipline Results

<u>Activity</u>	<u>Attorney</u>	<u>CPA</u>	<u>EA</u>	<u>Unenrolled</u>	<u>Totals</u>
• Total Receipts					516
• Disbarments (FAD/Consent)	-	1	-	1	2
• Suspensions (FAD/Consent)	2	2	3	-	7
• Expedited Suspensions	29	25	7	-	61
• DDA/Other Conditions	-	1	2	-	3
• Censure	1	2	1	-	4
• Reprimands/Soft Letter					150
• Cease & Desists					50
• CWOS, LOJ , NCOA, CWOA					409
• Reinstatements					25
• Total Dispositions					813

## OPR Guidance

- Rights and Responsibilities of practitioners in Disciplinary Cases: <http://www.irs.gov/pub/irs-utl/rightsandresponsibilitiesofpractitioners.pdf>
- Guidance on Restrictions During Suspension or Disbarment: [http://www.irs.gov/pub/irs-utl/guidance\\_on\\_restrictions\\_during\\_suspension\\_or\\_disbarment.pdf](http://www.irs.gov/pub/irs-utl/guidance_on_restrictions_during_suspension_or_disbarment.pdf)
- Information (resources) for Tax Professionals: <http://www.irs.gov/Tax-Professionals/Enrolled-Agents/Information-for-Tax-Professionals>

## OPR Guidance (cont)

- Circular 230 Webinar- Soup to Nuts:  
<http://www.irsvideos.gov/Circular230OverviewWebinar/>
- FBAR Responsibility:  
[http://www.irs.gov/pub/irs-utl/fbar\\_document\\_on\\_irs\\_gov\\_ver\\_08-04-10.pdf](http://www.irs.gov/pub/irs-utl/fbar_document_on_irs_gov_ver_08-04-10.pdf)

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## Relevant Recent OPR Cases

- Tewolde: <http://www.irs.gov/uac/Newsroom/IRS-Office-of-Professional-Responsibility-Disbars-Return-Preparer-Accused-of-Filing-False>Returns>
- Bryson: [http://www.irs.gov/pub/irs-utl/bryson\\_decision\\_redacted-version%201.pdf](http://www.irs.gov/pub/irs-utl/bryson_decision_redacted-version%201.pdf)
- Tiongson: [http://www.irs.gov/pub/irs-utl/Tiongson%20-%20IRS\\_Ddecision%20on%20Tiongson%20Motion%20for%20Default%20\(FINAL\)%20-%204-3-13.pdf](http://www.irs.gov/pub/irs-utl/Tiongson%20-%20IRS_Ddecision%20on%20Tiongson%20Motion%20for%20Default%20(FINAL)%20-%204-3-13.pdf)
- Walker: <http://www.irs.gov/pub/irs-utl/Walker%20FAD%202-18-13.pdf>

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## Relevant Recent OPR Cases (cont)

- Bohn: <http://www.irs.gov/pub/irs-utl/Morton%20Bohn%20SJ%20Order%20-FINAL%20Redacted.pdf>
- Gee: [http://www.irs.gov/pub/irs-utl/opr-edgar\\_h\\_gee\\_jr\\_-\\_final\\_order.pdf](http://www.irs.gov/pub/irs-utl/opr-edgar_h_gee_jr_-_final_order.pdf)
- Tedder: <http://www.irs.gov/pub/irs-utl/GTedder%20Default%20Order%20-%20Redacted%20Version.pdf>

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## Key Circular 230 Due Diligence Provisions

- Diligence as to Accuracy (10.22)
- Due Diligence Standards – Returns/Docs (10.34)
- Competence (Proposed 10.35)
- Requirements for Written Advice (Proposed 10.37)
- Oral or Written Opinions (10.51(a)(13))

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## Diligence as to Accuracy (10.22)

- Must exercise Due Diligence in:
  - Preparing, approving and filing tax returns, documents, affidavits etc. relating to IRS matters.
  - Determining correctness of oral/written representations made to the client or to Treasury personnel.
- Reliance on Another's Work Product? With Reasonable Care.

## Standards for Tax Returns Section 10.34(a)

- May not sign a tax return or advise a position on a tax return, willfully, recklessly, or through gross incompetence if:
  - Lacks reasonable basis
  - Unreasonable position (6694(a)(2))
  - Willful attempt to understate liability (6694(b)(2)(A))
  - Reckless, intentional disregard of rules and regulations (6694(b)(2)(B))
- Patterns matter

## Disclosure re: Unreasonable Positions (10.34(c))

- Advised position?
- Prepared or signed return?
- Submitting docs/other papers to IRS?
- Then-
  - Must Advise Client of Potential Penalties and their Avoidance through Disclosure

## Standards for Documents and Other Papers- 10.34(b)

- May not advise taking Positions that are Frivolous.
- May not advise Submissions:
  - to delay or impede tax administration
  - that are frivolous
  - Containing or omitting information that demonstrates an intentional disregard of rules or regulations.

## Reliance on Client Data- 10.34(d)

- Reliance on Client Information in good faith, without verification, is OK, but...
  - Cannot ignore implications of other information furnished
  - Cannot ignore actual knowledge
  - Must make reasonable inquiries for incorrect, inconsistent or incomplete information
- No Willful Blindness.

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## Proposed §10.35.

- A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.
- See ABA Model Rule 1.1, "Competence"
- AICPA Code of Professional Conduct Article V, "Due Care".

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## Prop. §10.37 Requirements for written advice

- Reasonable factual and legal assumptions
- Reasonably consider all relevant facts
- Reasonable efforts to identify and ascertain the relevant facts
- Not rely upon representations, statements, findings, or agreements if reliance would be unreasonable
- Not take into account the possibility that a tax return will not be audited, or that a matter will not be raised on audit.

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## Prop. 10.37 (cont)

- Reliance on taxpayer is unreasonable if the practitioner knows or should know that one or more representations, or assumptions on which any representation is based, are incorrect or incomplete
- May only rely on the advice of another practitioner if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances .
- May not rely on another practitioner who has a conflict; or is incompetent

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## Oral or Written Opinions – 10.51(a)(13)

- Disreputable/Incompetent Conduct
  - False opinions-knowingly, recklessly, through gross incompetence;
  - Intentional or recklessly misleading opinions;
  - Pattern of Incompetent Opinions

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## 10.51(a)(13) (cont)

- False Opinion =
  - knowing misstatements of fact/law;
  - assertion of unwarranted positions;
  - Counseling/assisting conduct known to be illegal/fraudulent;
  - concealing matters required by law to be revealed.

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## 10.51(a)(13) (cont)

- Reckless conduct=
  - highly unreasonable omission/misrepresentation involving extreme departure from standards of ordinary care that a practitioner should observe under the circumstances
- Gross Incompetence=
  - gross indifference, grossly inadequate preparation, consistent failure to perform obligations to client
- Patterns matter

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## More Info?

- Office of Professional Responsibility  
1111 Constitution Ave. N.W.  
SE:OPR Rm. 7238  
Washington, D.C. 20224
- Information on OPR, Circular 230 and Discipline visit:  
<http://www.irs.gov/Tax-Professionals/Circular-230-Tax-Professionals>

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# **Federal Tax Selected Start-Up Issues**

Nicholas (Nick) Connors, IRS, San Jose

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## Topics

- Federal Entity Selection
- And:
  - Flow-Through Loss Limitation issues
  - Start-Up and R&D expenses

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## Choice of Entity

- Five major entities:
  - Sole proprietorships
  - Partnerships (general and limited)
  - LLCs
  - S corporations
  - C corporations

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## Election & Default Rules

- One member
  - Sole Proprietorship (default) / Corporation
- More than one member
  - Partnership (default) / Corporation
- Taxpayer selects “effective” date:
  - 75 days < “filing date” < 12 months
  - §301.7701-3(c)(1)(iii)



**Election, Check the Box, Form 8832**

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<b>Form 8832</b> (December 1996) Department of the Treasury Internal Revenue Service		<b>Entity Classification Election</b>		OMB No. 1545-1516
<b>Please Type or Print</b>	Name of entity		Employer identification number (EIN)	
	Number, street, and room or suite no. If a P.O. box, see instructions.			
	City or town, state, and ZIP code. If a foreign address, enter city, province or state, postal code and country.			
<b>1 Type of election</b> (see instructions): <ul style="list-style-type: none"> <li>a <input type="checkbox"/> Initial classification by a newly-formed entity (or change in current classification of an existing entity to take effect on January 1, 1997)</li> <li>b <input type="checkbox"/> Change in current classification (to take effect later than January 1, 1997)</li> </ul>				
<b>2 Form of entity</b> (see instructions): <ul style="list-style-type: none"> <li>a <input type="checkbox"/> A domestic eligible entity electing to be classified as an association taxable as a corporation.</li> <li>b <input type="checkbox"/> A domestic eligible entity electing to be classified as a partnership.</li> <li>c <input type="checkbox"/> A domestic eligible entity with a single owner electing to be disregarded as a separate entity.</li> <li>d <input type="checkbox"/> A foreign eligible entity electing to be classified as an association taxable as a corporation.</li> <li>e <input type="checkbox"/> A foreign eligible entity electing to be classified as a partnership.</li> <li>f <input type="checkbox"/> A foreign eligible entity with a single owner electing to be disregarded as a separate entity.</li> </ul>				
<b>3</b> Election is to be effective beginning (month, day, year) (see instructions) . . . . . ▶ / /				
<b>4</b> Name and title of person whom the IRS may call for more information			<b>5</b> That person's telephone number	

## Sole Proprietorship

- One owner – non-incorporated
- Form 1040
- Individual & Self-Employment (SE) tax rates
- The owner and business have same tax year
- Formation is easy and tax-free
- Dissolution is easy and generally tax-free
- Unlimited liability

## Partnerships

- 2 or more owners
- Flow through of profit and loss to the owners
- Tax is at the owners' level and tax rates (exception for General Partners (SE Tax § 1402(a)).
- Same tax year as the owners
- Formation is usually tax-free
- Dissolution usually tax-free (inside / outside basis)
- Limited liability (except for General Partners)

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## Limited Liability Companies (LLC's)

Can be taxed as:

- Partnership: Form 1065 (**IRS Audit issue:** SE Tax?)
- Corporation: Form 1120 or Form 1120S or
- Disregarded:
  - Form 1040
  - Form 1065
  - Form 1120
  - Form 1120S

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## Example: LLC Disregarded Entity

Q: Stanford is a partnership that operates a successful family restaurant chain. They decide to open up a bar located next to one of the restaurants, but had concerns regarding the potential liability. So they establish Stanford Bar & Grill (SB&G) LLC, no entity election is made. **How is this reported?**

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## Example: LLC Disregarded Entity

Q: Stanford is a partnership that operates a successful family restaurant chain. They decide to open up a bar located next to one of the restaurants, but had concerns regarding the potential liability. So they establish Stanford Bar & Grill (SB&G) LLC, no entity election is made. **How is this reported?**

A: Since SB&G LLC has only one member, although it is a separate legal entity for state purposes, it is disregarded for federal tax purposes; treated as a division of Stanford. SB&G LLC's income, loss or deductions will be included as part of Stanford's Form 1065.

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## S Corporations

- Limited ownership: 100 SH's, no foreign investors
- 'Usually' no tax at the corporate level
- Tax is at the owner's level and tax rates
  - **IRS audit issue:** "reasonable compensation"
- S-Corp is usually on a calendar year
- Dissolutions can be taxable
- Distributions are usually tax-free
- Limited liability to the owners

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## C Corporations

- No restrictions on the type of owner
- Separate tax rates for a C Corp
- Double taxation
- Unrestricted on choice of tax year (almost)
- Dissolutions / Distributions are usually taxable
- Limited liability to the owners
- **IRS Audit Issue:** Debt vs. Dividend

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## Loss Limitation Issues (Big IRS Audit Issue)

- Sole Proprietorship: Full allowance
- C Corp: Full allowance
- Partnership Debt Allocation standard:
  - Recourse: “economic risk of loss”; § 1.752-2(b)(1)
  - Non-Recourse: Based on “3” tiers §1.752-3(a)
- S Corp Debt Allocation:
  - The § 1366(d) ceiling on loss deductions includes a shareholder’s adjusted basis for debt claims against the S corp.
  - A mere guarantee by a shareholder is ordinarily not sufficient; “economic outlay” required.

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## §195 Start-Up Costs

- Deduction:
  - Generally not deductible; §195
  - Up to \$5k – ratably reduced dollar-for-dollar when start-up exp’s > \$50k
- Amortize:
  - Remainder of Exp’s over 180 months starting with the month the “trade or business begins” §195(d).
- **IRS Audit Issue:** If no election, start-up cost deduction not allowed until business is sold §195(a).  
Jackson v. Commissioner, T.C. Memo. 2008-70.

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## Don't Forget...Research & Development

- Well deserved reputation for complexity:
  - **Amortization** §174: Gives choice to either deduct or amortize QRE's (Qualified Research Expenses) over a period not less than 60 months.
  - **Credit:** §41
    - Regular Research Credit (RRC): Base period can go back to 1984 (???)
    - **Alternate Simplified Credit (ASC):** Good for start-ups:
      - Up to 14% of qualified R&D expenses
      - No Gross Receipts Requirement
    - Alternate Incremental Credit (AIC)
  - **Both??** Possible...see §280C(1) through §280C(3)

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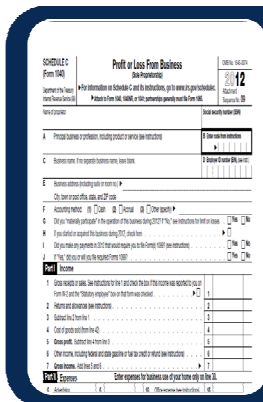
## Contacts

- [www.irs.gov](http://www.irs.gov)
- Vivienne Antal, Senior Stakeholder Liaison  
[Vivienne.Antal@irs.gov](mailto:Vivienne.Antal@irs.gov)  
Tel: 510-637-1902
- Nicholas Connors, SEP Group Manager  
[Nicholas.J.Connors@irs.gov](mailto:Nicholas.J.Connors@irs.gov)  
Tel: 415-837-6470

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 <p>State of California Franchise Tax Board</p>	2013	
<h1>Advising the New Business Venture</h1> <h2>State and Local Tax Considerations</h2>		
<p>Presented by Franchise Tax Board's Small Business Education and Outreach Section</p>		

## Sole Proprietorship Characteristics



The image shows a portion of the IRS Form 540, Schedule C, Profit or Loss From Business. The form is titled 'SCHEDULE C Form 540 Profit or Loss From Business (2012)'. It includes instructions for reporting business income and expenses. The form is partially filled out with various numbers and checkboxes.

- Sole proprietors use Schedule C to report the business' profit or loss on their Form 540 income tax returns whether distributed or not.
- Losses generally offset other income.
- Sole proprietor is not considered to be an employee of the business.



## Partnership Characteristics

The image shows a thumbnail of the 2012 California Partnership Return of Income (Form 565). The form is titled "2012 Partnership Return of Income" and "565". It includes sections for "Partnership Information", "Partnership Income", and "Partnership Expenses". The form is designed for reporting the income and expenses of a partnership for the year 2012.

- Not a separate taxable entity.
- Partnership files informational return using Form 565.
- Partners report profit or loss on their individual Form 540 income tax returns whether distributed or not.
- Losses may be limited.

## California Legal Entities

Formed by filing the appropriate document or form with the Secretary of State (SOS).

### Limited Partnership

- Certificate of Limited Partnership
- Form LP-1

### Limited Liability Partnership

- Begin as General Partnership
- Application to Register a Limited Liability Partnership
- Form LLP-1

Taxed annually until formally closed.

## California Legal Entities

Formed by filing the appropriate document or form with the SOS.

### Corporation

- Articles of Incorporation
- Various Forms
- Minimum Tax

### Limited Liability Company

- Articles of Organization
- Form LLC-1
- Annual Tax and Fee

Taxed annually until formally dissolved or cancelled.

## Limited Partnership and Limited Liability Partnership Characteristics

The image shows a thumbnail of the California Form 565, Partnership Return of Income, for the year 2012. The form includes sections for identifying the partnership, reporting income, and calculating the partnership's tax liability. Key sections visible include:
 

- Partnership Information (Name, FEIN, State of formation)
- Partnership Income (Total income, Deductions, Net income)
- Partnership Expenses (Total expenses, Net expenses)
- Partnership Tax (Total tax liability, Tax credits, Net tax liability)

- Not a separate taxable entity.
- Subject to \$800 annual tax.
- Partnership files informational return using Form 565.
- Partners report profit or loss on their individual Form 540 income tax returns whether distributed or not.
- Losses may be limited.

## C Corporation Characteristics

Thumbnail of California Corporation Franchise or Income Tax Return Form 100 for 2012. The form includes fields for corporation name, address, and various tax-related checkboxes and sections.

- Files using Form 100.
- Taxed annually on its earnings at a rate of 8.84% on net income.
- Subject to \$800 minimum tax.
- Shareholders taxed on distributed dividends.

## S Corporation Characteristics

Thumbnail of California S Corporation Franchise or Income Tax Return Form 100S for 2012. The form includes fields for corporation name, address, and various tax-related checkboxes and sections.

- A hybrid business entity.
- Files using Form 100S.
- State tax rate of 1.5% of net income. Not subject to federal tax.
- Subject to \$800 minimum tax.
- Shareholders report profit or loss on their individual Form 540 income tax returns whether distributed or not.

## LLC Characteristics Single Member and Partnership

Thumbnail of California Form 568, 2012 Return of Income for a Limited Liability Company. The form includes sections for identifying the taxpayer, reporting income, and calculating the tax liability. A yellow box at the top reads 'Get 568-Billed to you by subscription for the 2012 Form'.

- Single or partnership classified LLCs file using Form 568.
- Subject to \$800 annual tax.
- Maybe subject to an LLC fee based on total income (gross income plus cost of goods).
- Members report their share of profit or loss on Form 540 income tax returns whether distributed or not.

## LLC Fee\*

If total California annual income from Form 568 is:

Equal to or over:	But not over:	The fee is:
\$ 250,000	\$ 499,999	\$ 900
500,000	999,999	2,500
1,000,000	4,999,999	6,000
5,000,000	and over	11,790

Estimated LLC fee due June 15.

\*Does not apply if taxed as a corporation.

## LLC Characteristics C Corporation Classification

Thumbnail of California Corporation Franchise or Income Tax Return Form 100 for 2012. The form includes fields for corporation name, address, city, state, and ZIP code. It also contains sections for Schedule M (Business Component or Sub-F) and Schedule M-1 (Income Statement or Sub-F).

- C Corporation classified LLCs file using Form 100.
- Taxed annually on its earnings at a rate of 8.84% on net income.
- Subject to \$800 minimum tax.
- Members receive profits and losses like C corporation shareholder.

## LLC Characteristics S Corporation Election

Thumbnail of California S Corporation Franchise or Income Tax Return Form 100S for 2012. The form includes fields for corporation name, address, city, state, and ZIP code. It also contains sections for Schedule M (Business Component or Sub-F) and Schedule M-1 (Income Statement or Sub-F).

- S Corporation classified LLCs file using Form 100S.
- State tax rate of 1.5% on net income. Not subject to federal tax.
- Subject to \$800 minimum tax.
- Members report their share of profit or loss on Form 540 income tax returns whether distributed or not.

## Forms of Ownership Information



FTB Publication 1123, *Franchise Tax Board's Guide to Forms of Ownership*

## Go-Biz

Offers a range of services to business owners including:

Clearing of  
regulatory  
hurdles

Permit  
streamlining  
CalGOLD

Retention and  
expansion  
services

Assistance with  
state  
government  
attraction

Site selection

Small business  
assistance

Customer  
attraction

International  
trade  
development



[www.business.ca.gov](http://www.business.ca.gov)

# New Power of Attorney Form

Separate Power of Attorney required for each joint filer.

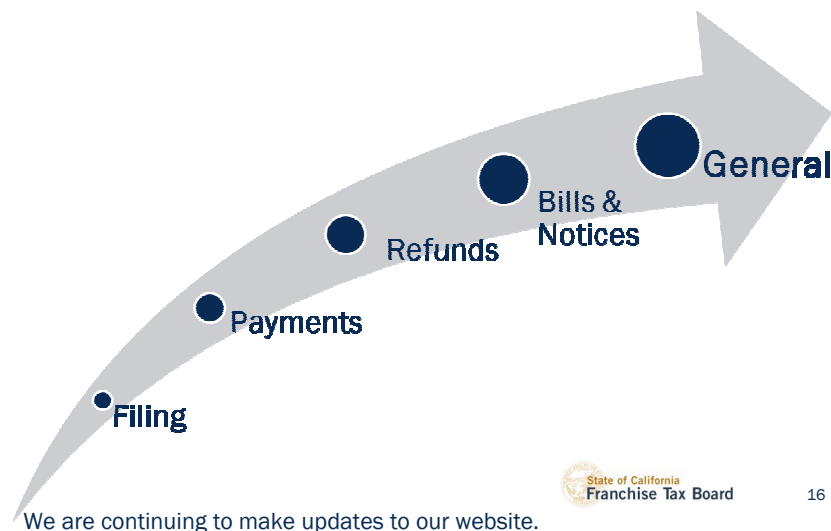
Revised taxpayer and representative information sections.

FTB Form 3520

“Super Box.” Allows authorization for all tax years. Automatically expires in four years.

Expanded instruction and additional checkboxes for representative privileges.

## E-Services Before you Call



We are continuing to make updates to our website.

## MyFTB | ACCOUNT

After completing a one-time registration process, an authorized tax representatives can:

Get wage information.

Verify California withholding.

Verify estimated tax payments.

View balances due.

View FTB-issued 1099 forms.

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## Web Pay Pay Taxes Online

Pay estimated tax.

Pay any FTB bills.

Sign up for email reminders of upcoming estimate payment due dates.

Save bank account information for future payments.

Cancel pending payments.

Schedule payments up to one year in advance.



## Monthly Installment Agreements

Owe \$25,000  
or less.

Repay within  
five years.

All required  
returns filed.

Available online at [FTB.CA.GOV](http://FTB.CA.GOV)  
By phone at 800.689.4776



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Connect with an FTB representatives to get  
answers to general questions about:

Online  
Services

Personal  
or  
Business  
Taxes

FTB's  
Website

**Available weekdays 7 a.m. to 5 p.m.**

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Free Monthly Online Publication

Topics:

- State Income Tax Laws
- Regulations
- Policies & Procedures
- Events for Tax Professionals

Register at:  
FTB.CA.GOV



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## Brenda Voet Technical Advisor to the Taxpayers Advocate

Telephone

• 916.845.5613

Email

• [Brenda.Voet@ftb.ca.gov](mailto:Brenda.Voet@ftb.ca.gov)



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### Purpose of Collecting Business Tax

- Cities tend to impose business tax for revenue or regulatory purposes or both.
  - The City of Santa Clara generally collects business tax for revenue and compliance purposes, as opposed to a regulatory tax, which is more of a 'license' to do business.
  - City of Santa Clara City Code Section 3.40.010: *"Purpose: This chapter is enacted solely to raise revenue for municipal purposes and not for the purpose of regulation. Ord. 1721 § 2, 10-27-98. Formerly § 15-1.100."*
  - The City of Santa Clara does have some regulatory businesses (e.g. adult book stores, massage establishments, etc.). These businesses must apply with the Police Department/Permits Unit before payment of tax.
  - The City of Santa Clara maintains a record of any entity transacting business in our City, in order to ensure that they are paying the appropriate tax.

John Kachmanian, Customer Service Supervisor  
City of Santa Clara Finance Department

6/19/13

### City of Santa Clara Requirement to Pay Business Tax – Who and how much?

- Who?
  - Anyone transacting business or occupying a business office, even if not transacting business. The business entity does not need to be physically located in the City of Santa Clara.
  - Property owners of three or more rental units are required to pay a rental unit fee for each rental unit.
  - Businesses who have 501C IRS Exemption are exempt from paying business tax (must provide letter from IRS).
- How much?
  - The business tax amount varies, based on the type and size of business (as opposed to a tax based on a percentage of gross receipts).
  - Business Tax fee schedule is described in Code Sections 3.40.310 – 3.40.350.
  - Fire fees are typically collected along with the business tax (this is unique to the City of Santa Clara).
- Reference materials
  - New Business Tax Affidavit
  - Rental Unit Tax Affidavit
  - Business Tax Certificate
  - More information at: <http://santaclaraca.gov/>

## Ensuring business tax compliance and common issues

- What to do if it is discovered that a business is not paying its tax
  - Advise business that all businesses transacting or occupying office space in the City of Santa Clara are required to obtain a business tax certificate by paying business tax. Ask them to contact the City's business tax office at (408) 615-2310 for more information.
- General tips for business tax success
  - Obtain/renew certificate on time
  - Ensure information provided on business tax forms is accurate and complete
  - Timely notification to the City of business closure or any business changes (address, ownership, etc.), to ensure timely receipt of business tax correspondence and to avoid penalties.
- Common issues
  - Not renewing annual business tax on time results in a 100% penalty, per City Code 3.40.110.
  - Failure to notify the City of Santa Clara of business closure leads to the possibility of penalties, a citation, and business tax account being turned over to Collections.
  - Home Occupations may not be aware of need to pay business tax.

**ANNUAL BUSINESS TAX CERTIFICATE / FIRE PERMIT**  
POST CONSPICUOUSLY AT SANTA CLARA LOCATION  
NOT TRANSFERABLE, REFUNDABLE OR ASSIGNABLE

**CITY OF SANTA CLARA**  
MUNICIPAL SERVICES / BUSINESS TAX  
1500 Warburton Avenue - Santa Clara, CA 95050  
Phone (408) 615-2310

Issuance of this receipt does not preclude the need to comply with all federal, state, and city laws applicable to the type and/or location of the business. This certificate is valid only for the below stated location and must be renewed within 30 days after expiration date noted below or fees will be doubled. It is the taxpayer's responsibility to renew this certificate annually or close the account by submitting a written request, otherwise additional fees will apply. A separate tax certificate/fire permit must be obtained for each location within the City of Santa Clara.

**BUSINESS DESCRIPTION:**  
**TYPE OF BUSINESS:**  
**SANTA CLARA LOCATION:**

TEST COMPANY  
1500 WARBURTON AVE  
SANTA CLARA, CA 95050

**CERTIFICATE NO. 119535**  
**BUSINESS TAX PAID \$ 0.00**  
**FIRE PERMIT FEES PAID \$ 0.00**  
**EXPIRES** January 25, 2013

Change to a residential address must be submitted in person. This includes a move from one residence to another.

**THIS REVENUE RECEIPT IS ISSUED WITHOUT VERIFICATION THAT THE TAXPAYER IS SUBJECT TO OR EXEMPT FROM LICENSING BY THE STATE. ANY CHANGE IN ADDRESS, COMPANY NAME OR TYPE OF BUSINESS MUST BE SUBMITTED IN WRITING AND REQUIRES A \$6.00 FEE.**



# City of Santa Clara

Municipal Services Division - Business Tax Unit  
1500 Warburton Ave, Santa Clara, CA 95050  
Phone: (408) 615-2310 Fax: (408) 241-1543

BC# \_\_\_\_\_  
For Office Use Only

## New Business Tax Affidavit

**Instructions:**

1. All questions must be answered or designated not applicable (N/A), as appropriate.
2. Carefully read the "Note to Applicant" section.
3. Additional information may be required (see section on "Additional Forms Required").
4. Make checks payable to the City of Santa Clara and submit with completed affidavit.
5. A separate application must be completed for each location and for each business at the same location.

**PLEASE TYPE OR PRINT CLEARLY IN INK**

Business Name: \_\_\_\_\_ DBA: \_\_\_\_\_  
 Business Address: \_\_\_\_\_  
 Mailing Address \_\_\_\_\_

Business Phone: \_\_\_\_\_  
 Email: \_\_\_\_\_

Is this business going to be conducted in your home in Santa Clara?  
 Yes  No *If yes, application must be submitted in person and applicant must first obtain the Home Occupation Rules and Regulations*

Do you claim an exemption to pay Business Tax?  
 Yes  No *If yes, include proof of exemption as provided by Internal Revenue Service (Form 501C)*

Will you distribute handbills or flyers door to door? *If yes, please obtain a copy of regulations concerning handbill distribution from the Finance Department.*  
 Yes  No

Ownership:  Corporation  Ltd Liability Co (LLC)  Partnership  Sole Proprietorship/Individual  
 (Check one)  
 Federal Tax ID (FEIN): \_\_\_\_\_ (FEIN required for Corporation, LLC, and Partnership)

Please list information regarding the business owner (s) and/or all partners and officers: (attach additional sheet, if necessary)

Name	Title	Alternate Address (Cannot be PO Box)	Alternate Phone #	Social Security # (for Sole Proprietors/Individuals)
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

Business Description: \_\_\_\_\_

Sellers Permit #: \_\_\_\_\_ (Resellers License/BEAN)  
 Contractors License #: \_\_\_\_\_ Class: \_\_\_\_\_

Emergency Contact:  
 Name: \_\_\_\_\_ Address: \_\_\_\_\_  
 Phone: \_\_\_\_\_

**TO CALCULATE FEES, PLEASE COMPLETE THE FOLLOWING:**

For a corporation or LLC, enter 1 otherwise, enter 0:  
 Number of people (full and part-time/paid or unpaid) engaged in the conduct of business at this Santa Clara address, including owners, partners, officers, and employees: \_\_\_\_\_  
 Total both lines: \_\_\_\_\_

**Based on the Fee Schedule on the reverse side (Page 2) of the form:**

ALL TAXES AND FEES ARE NON-TRANSFERABLE AND NON-REFUNDABLE

Business Tax: \_\_\_\_\_  
 Fire Permit Fee: \_\_\_\_\_  
 State CASp Fee: \$1.00  
 Total Fee: \_\_\_\_\_

The issuance of a certificate under the provisions of this chapter to a particular certificate holder does not constitute approval, direct or indirect, by the city that the certificate holder may operate such business in violation of any of the provisions of the City Code, ordinances or resolutions or any law of the state or federal government. Any business to whom a certificate has been issued under this chapter will continue to be required, after the issuance thereof, to comply with all the laws of the city including, but not limited to its zoning regulations, building regulations, fire regulations, plumbing regulations, electrical regulations, mechanical code and subdivision regulations. (Code, Sections 3.40.220, 3.40.230)

**Signature** \_\_\_\_\_ **Date** \_\_\_\_\_  
**Print or Type Name** \_\_\_\_\_ **Title** \_\_\_\_\_

**NOTE TO APPLICANT:**

Notice: Under federal and state law, compliance with disability access laws is a serious and significant responsibility that applies to all California building owners and tenants with buildings open to the public. You may obtain information about your legal obligations and how to comply with disability access laws at the following agencies: The Division of the State Architect at [www.dgs.ca.gov/dsa/Home.aspx](http://www.dgs.ca.gov/dsa/Home.aspx) - The Department of Rehabilitation at [www.rehab.cahwnet.gov](http://www.rehab.cahwnet.gov) - The California Commission on Disability Access at [www.ccca.ca.gov](http://www.ccca.ca.gov)

1. Businesses with a fixed location in the City of Santa Clara pay both the Business Tax and Fire Inspection Permit Fee.
2. Businesses located out of the City of Santa Clara pay the Business Tax only.
3. Calculate Business Tax and Fire Inspection Fee from the rates listed below.
4. Businesses with an alarm system must register with the Santa Clara Police Department at (408) 615-4871.
5. All Business Tax Certificates must be renewed or cancelled at time of expiration or additional fees/penalties will apply.
6. Per City Code 3.40.110, any person that fails to apply for a tax certificate within 30 days of commencing business or occupying space in the business community, is subject to 100% penalty of total amount due.

**Annual BUSINESS TAX Fee Schedule**

**Instructions for New Business Tax Affidavit: To Calculate Annual Business Tax, Complete 1 or 2. Also Complete 3 if applicable.**

**1. Businesses with a Fixed Place of Business within the City of Santa Clara:**

The total number from front page is used to determine the tax due.

**2. Businesses Outside the City of Santa Clara that conduct business in Santa Clara:**

**A.** Businesses not having a fixed place of business within the City but conduct business within the City: **\$45.00** per year

**B.** Businesses providing regular and established route service in the city by use of vehicles: **\$23.00** per vehicle per year

**C.** Vending machine operators: **\$79.00** per year

**D.** Automatic coin operated amusement machines (including peep-show devices): **\$60.00** each per year. Juke Boxes **\$30.00** each per year

**3. Regulated Businesses:**

**Applicants for these business types must apply with the Police Department/Permits Unit before payment of tax:**

Itinerant merchants, Peddlers, Solicitors, Adult book stores, advertising benches, ambulance services, carnivals, circuses, detectives/private investigators, entertainment permits, escort services, pawnbrokers, seasonal lots, secondhand dealers, taxicabs, massage therapist/establishments and theaters.

Santa Clara Police Department/Permits Unit: (408) 615-4867

Schedule 100 Commercial/Industrial	
1.....	\$ 15.00
2-5.....	\$ 30.00
6-10.....	\$ 70.00
11-15.....	\$ 90.00
16-20.....	\$ 115.00
21-25.....	\$ 175.00
26-30.....	\$ 225.00
31-40.....	\$ 280.00
41-55.....	\$ 330.00
56-75.....	\$ 380.00
76-100.....	\$ 460.00
101 +.....	\$ 500.00

Schedule 200 Professional	
1.....	\$ 15.00
2-3.....	\$ 30.00
4-6.....	\$ 70.00
7-10.....	\$ 90.00
11-20.....	\$ 115.00
21-25.....	\$ 175.00
26-35.....	\$ 225.00
36-40.....	\$ 280.00
41-45.....	\$ 330.00
46-50.....	\$ 380.00
51-55.....	\$ 460.00
56 +.....	\$ 500.00

Schedule 300 Manufacturing	
1-3.....	\$ 15.00
4-20.....	\$ 45.00
21-30.....	\$ 65.00
31-50.....	\$ 100.00
51-75.....	\$ 135.00
76-100.....	\$ 175.00
101-125.....	\$ 225.00
126-175.....	\$ 280.00
176-225.....	\$ 330.00
226-300.....	\$ 380.00
301-400.....	\$ 460.00
401 +.....	\$ 500.00

All State Licensed Contractors  
\$45.00

**Annual FIRE PERMIT Fees Schedule**

**THE UNIFORM FIRE CODE REQUIRES THAT ALL FIXED PLACES OF BUSINESS IN THE CITY OF SANTA CLARA OBTAIN A FIRE PERMIT FOR THE FACILITY OR ACTIVITY ANNUALLY**

**HOME OCCUPATION LIGHT/ORDINARY HAZARD: \$32.35; COMMERCIAL LIGHT/ORDINARY HAZARD: \$49.10**

**ADDITIONAL LIFE SAFETY INSPECTION PERMIT FEES**

Due to specific activities of your business, other permits may be required. These permits constitute permission to maintain, store, use or handle certain materials; or to conduct activities which produce conditions hazardous to life or property, and will be determined during the Fire Department inspection. If it is determined that additional fire permit fees are due, you will be billed accordingly.

**SHOULD YOU HAVE QUESTIONS ABOUT FIRE PERMIT FEES, CALL THE FIRE DEPARTMENT AT (408) 615-4900.**

**Additional Forms Required for fixed places of business in the City of Santa Clara**

Submit copies of all that apply to your type of business. If uncertain, please call the following agencies:

<u>Form Name:</u>	<u>Agency Name:</u>	<u>Address/Phone:</u>
Fictitious Business Name	Santa Clara County	70 W Hedding, San Jose, CA 95110 - (408) 299-5688
Articles of Incorporation from State of California	Secretary of State of California	1500 11th St, Sacramento, CA 95814 - (916) 653-6814
Sellers Permit	State Board of Equalization	250 S 2nd St, San Jose, CA 95113 - (408) 277-1231
Health Certificate	Department of Health	1555 Berger Dr 300, San Jose, CA 95112 - (408) 918-3400

**FOR CITY USE ONLY**

	Approval Signature	Date	Comments
Home Occupation Planning			
Building			



City of Santa Clara  
 Municipal Services Division - Business Tax Unit  
 1500 Warburton Ave, Santa Clara, CA 95050  
 Phone: (408) 615-2310 Fax: (408) 241-1543

BC# \_\_\_\_\_  
 For Office Use Only

## New Rental Unit Tax Affidavit

**Instructions:**

1. All questions must be answered or designated not applicable (N/A), as appropriate.
2. Carefully read the "Note to Applicant" section.
3. Additional information may be required (see section on "Additional Forms Required").
4. Make checks payable to the City of Santa Clara and submit with completed affidavit.
5. A separate application must be completed for each location.

**PLEASE TYPE OR PRINT CLEARLY IN INK**

Business Name: \_\_\_\_\_ DBA: \_\_\_\_\_  
 Business Address: \_\_\_\_\_  
 Mailing Address: \_\_\_\_\_  
 Business Phone: \_\_\_\_\_ Fax: \_\_\_\_\_ Email: \_\_\_\_\_

Has the applicant had a business certificate in Santa Clara in the past? <input type="checkbox"/> Yes <input type="checkbox"/> No	Do you claim an exemption to pay Business Tax? <input type="checkbox"/> Yes <input type="checkbox"/> No <i>If yes, include proof of exemption as provided by Internal Revenue Service (Federal Form 501C)</i>
---	--

Ownership:  Corporation  Ltd Liability Co (LLC)  Partnership  Sole Proprietorship/Individual  
 (Check one)  
 Federal Tax ID (FEIN): \_\_\_\_\_ (FEIN required for Corporation, LLC, and Partnership)

Please list information regarding the business owner (s) and/or all partners and officers: (attach additional sheet, if necessary)

Name	Title	Alternate Address <i>(Cannot be PO Box)</i>	Alternate Phone #	Social Security # <i>(for Sole Proprietors/Individuals)</i>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

Business Description: \_\_\_\_\_

Emergency Contact:  
 Name: \_\_\_\_\_ Phone: \_\_\_\_\_  
 Address: \_\_\_\_\_ Cell: \_\_\_\_\_

Property Manager:  
 Name: \_\_\_\_\_ Phone: \_\_\_\_\_  
 Address: \_\_\_\_\_ Cell: \_\_\_\_\_

**Enter fees from reverse side (Page 2) of the form:**

Business Tax:	_____
Hotel/Motel Fee:	_____
Fire Permit Fee:	_____
State CASp Fee:	\$1.00
Total Fee:	_____

**ALL TAXES AND FEES ARE  
NONTRANSFERABLE AND NONREFUNDABLE**

The issuance of a certificate under the provisions of this chapter to a particular certificate holder does not constitute approval, direct or indirect, by the city that the certificate holder may operate such business in violation of any of the provisions of the City Code, ordinances or resolutions or any law of the state or federal government. Any business to whom a certificate has been issued under this chapter will continue to be required, after the issuance thereof, to comply with all the laws of the city including, but not limited to its zoning regulations, building regulations, fire regulations, plumbing regulations, electrical regulations, mechanical code and subdivision regulations. (Code, Sections 3.40.220, 3.40.230)

**Signature** \_\_\_\_\_  
**Print or Type Name** \_\_\_\_\_

**Date** \_\_\_\_\_  
**Title** \_\_\_\_\_

**NOTE TO APPLICANT:**

Notice: Under federal and state law, compliance with disability access laws is a serious and significant responsibility that applies to all California building owners and tenants with buildings open to the public. You may obtain information about your legal obligations and how to comply with disability access laws at the following agencies: The Division of the State Architect at [www.dgs.ca.gov/dsa/Home.aspx](http://www.dgs.ca.gov/dsa/Home.aspx) - The Department of Rehabilitation at [www.rehab.cahwnet.gov](http://www.rehab.cahwnet.gov) - The California Commission on Disability Access at [www.cdda.ca.gov](http://www.cdda.ca.gov)

1. Businesses with a fixed location in the City of Santa Clara pay both the Business Tax and Fire Inspection Permit Fee.
2. Calculate Business Tax and Fire Inspection Fee from the instructions listed below.
3. All Tax Certificates must be renewed or cancelled at time of expiration or additional fees/penalties will apply.
4. Three or more units require a Rental Unit Tax Affidavit
5. The Uniform Fire Code requires that all fixed places of business in the City of Santa Clara obtain a Fire Permit for the facility or activity annually. Should you have questions about these fees, call the Fire Department at (408) 615-4900.

**Instructions for RENTAL UNIT Tax Affidavit Fee Calculations:**

1. To determine tax due, total number of units and multiply by per unit cost shown below.
2. Calculate and enter amount on "Total Tax Due" line.
3. Hotels and Motels pay **\$3.00 per room** and **\$49.10 fire permit fee**. Additional fees may apply after fire inspection.
4. **HOMEOWNERS ASSOCIATIONS** are subject to an **\$11.00 per unit FIRE PERMIT FEE** only. Inquiries should be directed to the Fire Department at (408) 615-4900
5. Total tax and fees, then enter amount on the front (1st page) of this document.

List ALL Rental Units in Santa Clara. Include single family homes, apartments, Hotel or Motel units. Exclude owner's dwelling	ADDRESS WHERE UNITS ARE LOCATED IN THE CITY OF SANTA CLARA		Business Tax Fees \$5.22 per unit	Hotel/Motel Only \$3.00 per room	Fire Permit Fees \$11.00 per unit
COMPUTE TAX AT RIGHT	<b>TOTAL NUMBER OF UNITS</b>				
	<b>MULTIPLY TOTAL UNITS BY:</b>		X \$5.22	X \$3.00	X \$11.00
	<b>ENTER TOTAL TAX DUE</b>				

List any other certificate Numbers for Rental Units in Santa Clara # \_\_\_\_\_ # \_\_\_\_\_  
# \_\_\_\_\_ # \_\_\_\_\_

**Additional Forms Required for Corporation, LLC, or if using a DBA**

Submit copies of all that apply to your type of business. For more information, please contact the following agencies:

<b>Form Name:</b>	<b>Agency Name:</b>	<b>Address/Phone:</b>
Fictitious Business Name	County of Santa Clara	70 W Hedding, Recorder Office, San Jose, CA 95110 - (408) 299-5688
Articles of Incorporation from State of California	Secretary of State of California	1500 11th St, Business Programs, Sacramento, CA 95814 - (916) 653-6814

(Revised 11-12)



**IRS/SJSU**  
**Small Business Tax Institute**  
June 19, 2013

Presented by:  
**California State Board of Equalization**

What's New?

**e-reg**  
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Starting a Business  
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with  
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California State Board  
of Equalization [www.boe.ca.gov](http://www.boe.ca.gov) June 18, 2012

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**Doing Business Just Got Easier with e-reg**  
Electronic Registration & More

**What is eReg? (Español)**  
Electronic Registration (eReg) is a Convenient, Fast, and Free way to register online for a permit, license, or account with the BOE.

**Who can use eReg?**  
Anyone can use eReg quickly and conveniently with a computer and internet access.

**What are the benefits?**

- One click starts the process for the permits, licenses, and accounts
- You can easily apply for new licenses or add business locations
- The system is free to use but some permits, licenses, or accounts may require a fee or deposit
- View the status of your application(s) online
- Get emails with updates on the status of your application(s)
- Online help and live assistance during business hours
- Get links to reference materials related to your business activities

**What can I do?**

- Get a seller's permit
- Add a new business location to an existing BOE account
- Register to pay taxes on internet purchases of cigarette or tobacco products

Click Here to Get Started with e-reg

**e-relief requests**  
A fast, easy, and convenient way to electronically submit your relief requests.

Coming October 2012

**Declaration**  
of timely mailing

**Extension**  
of time in which to file a tax/fee return

**Request**  
for relief from penalty  
for relief from interest  
for relief from penalty and interest due to a disaster  
for relief from collection cost recovery fee

Good for You • Good for California | Learn more at [www.boe.ca.gov](http://www.boe.ca.gov) | California State Board of Equalization

## Board of Equalization Use Tax

If sales tax would apply when a particular item is purchased in California, use tax applies when a similar purchase is made from a retailer outside the state and no tax is charged.

- Use tax is imposed on the consumer
- A consumer owes and pays the use tax
- Tax measured by purchase price
- Use tax rate is the same as sales tax rate

## New Use Tax Registration Requirement Assembly Bill 155

- Effective September 15, 2012
- Expands use tax registration requirements to specific out-of-state retailers
- BOE has contacted over 200 out-of-state retailers who meet the requirements
- Businesses or individuals who are required to register should file for an account using BOE's eReg system
- For more information see:
  - <http://www.boe.ca.gov/sutax/abx1-28faq.htm>

## Board of Equalization Changes to Qualified Purchaser Program

- BOE discontinued its automatic registration of taxpayers. If taxpayers meet the requirements, *they* must now Register for a Qualified Purchaser account
- BOE now allows taxpayers to close their accounts if their gross receipts drop below \$100,000 for two consecutive years
- Currently BOE closes out taxpayers (QP) that file three consecutive returns with zero tax due

## Board of Equalization Estimated Use Tax Table

**MAKE ONLINE PURCHASES?  
YOU MAY OWE USE TAX.**

- You may owe "use tax" if you made a purchase from an out-of-state retailer and were not charged California tax on the purchase.
- If you have not saved your receipts, you may calculate and pay estimated use tax on your 2011 California Income Tax return, based upon your income.
- The Lookup Table below may be used to pay estimated use tax for personal items purchased for less than \$1,000 each.
- For more information about Use Tax, please visit: [California Use Tax Information](#).

**Example:**

SUBTOTAL (3 ITEMS)	\$69.95
SHIPPING	FREE
<div style="border: 1px solid red; padding: 2px; display: inline-block;">                     If you didn't pay California tax here then you likely owe use tax                 </div>	
<b>GRAND TOTAL</b>	<b>\$69.95</b>

CA Adjusted Gross Income (AGI) Range	Use Tax Liability
Less Than \$20,000	\$7
\$20,000 to \$39,999	\$21
\$40,000 to \$59,999	\$35
\$60,000 to \$79,999	\$49
\$80,000 to \$99,999	\$63

## Board of Equalization Estimated Use Tax Table

- Regulation 1685.5, adopted in 2011
- Taxpayers may use the table to estimate and report use tax on individual, non-business items purchased for less than \$1,000 each in lieu of reporting their actual use tax liability
- This option is only available for taxpayers who are permitted to report use tax on their income tax return

## Board of Equalization Estimated Use Tax Table

- To use the table, simply report the amount of use tax that corresponds to the adjusted gross income on the income tax return
- Taxpayers will not be assessed additional use tax on the individual, non-business items purchased for less than \$1,000 each
- If there is a combination of purchases above and below \$1,000 each, taxpayers have the option to use the table to report individual, non-business items purchased for less than \$1,000 each

## Board of Equalization Estimated Use Tax Table

2012 Estimated Use Tax Table – Regulation 1685.5

Adjusted Gross Income (AGI) Range		Use Tax Liability
Less Than \$10,000		\$2
\$10,000	to \$19,999	\$7
\$20,000	to \$29,999	\$12
\$30,000	to \$39,999	\$17
\$40,000	to \$49,999	\$22
\$50,000	to \$59,999	\$27
\$60,000	to \$69,999	\$32
\$70,000	to \$79,999	\$37
\$80,000	to \$89,999	\$42
\$90,000	to \$99,999	\$47
\$100,000	to \$124,999	\$56
\$125,000	to \$149,999	\$69
\$150,000	to \$174,999	\$81
\$175,000	to \$199,999	\$94
More than \$199,999 - Multiply AGI by 0.050% (.0005)		

## Board of Equalization Use Tax Outreach

- Banner ads for Use Tax Table
- Use Tax videos
- Letters to CPA's, EA's, and Tax Professionals
  - Pub 217, *Use Tax: Guide to Reporting Out-of-State Purchases*
- Letters to California residents regarding Use Tax (Tax Gap II)

## Board of Equalization Lumber Products Assessment

- Effective January 1, 2013
- A 1% assessment is imposed on a person who purchases lumber products or engineered wood products
- Includes lumber, plywood, particleboard, fiberboard, poles, posts, structural panels, decking, railings, fencing
- Does not include "secondary" wood products such as furniture, paper products, indoor finished flooring products, paneling, shutters, blinds, frames, window, doors, cabinets

## Board of Equalization Lumber Products Assessment

- Retailers who sell lumber products and engineered wood products are required to collect the lumber products assessment and remit it to the BOE
- Retailers are required to file a lumber products assessment schedule along with their sales and use tax return
- Emergency regulation is being implemented to allow reimbursable implementation costs for retailers



## Board of Equalization Additional New Legislation

- AB 1424, effective January 1, 2012
  - Expanded the top 250 tax debtor list to the top 500
  - Requires licensing agencies to refuse to issue or reactivate certain licenses to debtors on top 500
  - Prohibits state agencies from contracting with debtors on top 500
- AB 2270, effective January 1, 2013
  - Designates April 15<sup>th</sup> as the due dates for payments of use tax for “eligible purchasers” who have made taxable purchases during the preceding calendar year.

## Board of Equalization New Tax Credits and Exclusions

SB 1128 was recently passed. This will expand the green manufacturing exclusion to include alternative manufacturing.

To obtain the sales and use tax exclusion, please visit CAEATFA's website at:

*[www.treasurer.ca.gov/caeatfa](http://www.treasurer.ca.gov/caeatfa)*

For more information:

*[www.boe.ca.gov/sutax/gme.htm](http://www.boe.ca.gov/sutax/gme.htm)*



## Board of Equalization Industry Specific Webpages

- New friendly webpage design
- Includes pertinent publications, regulations, manuals, forms
- Industries already published are restaurants, liquor stores, construction contractors and caterers
- Tax practitioner page has also been published

## Board of Equalization No Cash – Specific Offices Only

THIS BOE OFFICE WILL  
**NO LONGER ACCEPT CASH**  
Effective June 1, 2011

You may pay by  
EPAY • CHECK • CASHIERS CHECK • MONEY ORDER  
and the following forms of CREDIT\*     

\*Please note that a convenience fee of 2.5% of the transaction amount will be charged by the credit card processing vendor, Official Payments Corporation. This convenience fee is retained by the vendor and is not remitted to the Board of Equalization. The minimum fee is \$1.00.



## Board of Equalization

# Other Topics

## Board of Equalization Public Meetings

- View a list of all BOE public meetings  
[www.boe.ca.gov/meetings/boardcomm.htm](http://www.boe.ca.gov/meetings/boardcomm.htm)
- Sign up to receive the public meeting agenda  
[www.boe.ca.gov/agenda/](http://www.boe.ca.gov/agenda/)
- Sign up to receive proposed regulatory changes  
[www.boe.ca.gov/aprc/index.htm](http://www.boe.ca.gov/aprc/index.htm)

## Board of Equalization If You Have a Problem

- We will work with you to resolve your tax or fee problem
- Contact the BOE right away if you have questions about your tax bill
- If you cannot pay the entire amount due, we recommend you pay as much as you can now because interest will continue to accrue until the tax is paid
- Payment Options
  - *Credit Card*
  - *Installment Payment Agreements*

## Board of Equalization Be Proactive

- Sign up for BOE updates by subscribing to our email lists  
*[www.boe.ca.gov/info/enotify.htm](http://www.boe.ca.gov/info/enotify.htm)*
- Watch online tutorials  
*[www.boe.ca.gov/sutax/tpsched.htm](http://www.boe.ca.gov/sutax/tpsched.htm)*
- Get help when you need it. Don't wait.  
*[www.boe.ca.gov/info/contact.htm](http://www.boe.ca.gov/info/contact.htm)*  
Toll-free: 800-400-7115

## Board of Equalization Where to Find Help

Visit the BOE website—it could save you a trip to a field office!

*[www.boe.ca.gov](http://www.boe.ca.gov)*

BOE's extensive website provides forms, publications, regulations, reports, tax news, meeting agendas, and special features for taxpayers, local governments, and the general public.

## California Tax Service Center

[www.taxes.ca.gov](http://www.taxes.ca.gov)



## Additional Help



- BOE Information Center:  
800-400-7115  
800-735-2929 (TDD)  
Mon. – Fri. 8am to 5pm PT
- 1-1 assistance
- 24 hr. fax back service
- [www.boe.ca.gov](http://www.boe.ca.gov)
- Tax Practitioner Hotline:  
800-401-3661
- BOE Offers in Compromise Section:  
916-322-7931


## Taxpayers' Rights Advocate



If you are unable to resolve an issue with the BOE, or if you would like to know more about your rights under the law, contact the Taxpayers' Rights Advocate at:

888-324-2798

[www.boe.ca.gov/tra/tra.htm](http://www.boe.ca.gov/tra/tra.htm)



**HF & JA** HOGUE FENTON  
Hoge Fenton Jones & Appel  
Attorneys at Law | Founded in 1952

**Data Security:  
Protecting Business Records  
– Legal Considerations**

**San Jose State University/IRS  
Small Business Tax Institute  
Techmart  
Santa Clara, CA  
June 19, 2013**

by Stephanie O. Sparks  
Chair, Privacy & Data Security Group

global REACH  
local KNOWLEDGE  
outstanding RESULTS

## Data Breach – Pervasive and Inevitable

- 608,087,870 records containing sensitive personal information were compromised in the U.S. since 2005
- In 2012, 17,317,184 records were compromised in the U.S. from 447 data breaches
- In 2013, 6,207,297 records were compromised in the U.S. from 255 data breaches thus far

*Sources: A Chronology of Data Breaches, Privacy Rights Clearinghouse, June 2013; Identity Theft Resource Center (ITRC) Breach Report, May 2013*

## Data Breach – The Reality

- **51% of CEOs surveyed say that their companies experience cyber attacks hourly or daily**
- **Two-thirds of data breaches globally in 2012 were caused by human error and system glitches**
- **47% of recorded breaches in the U.S. in 2012 were caused by malicious attacks (hacking and insider theft)**

*Sources: Ponemon Institute, 2010 survey; 2013 Cost of Data Breach Study, sponsored by Symantec, conducted by Ponemon Institute; A Chronology of Data Breaches, Privacy Rights Clearinghouse, 2012*

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## Data Breach – The Reality

- **66% of users store confidential or sensitive personal information on their smartphones**
- **46% of lost laptops contained confidential data**
- **75% of individuals who receive a data breach notification letter do not register for free credit monitoring**
- **12% of consumers care enough to take action regarding their sensitive personal information**

*Sources: Ponemon Institute, 2010 survey; The Billion Dollar Lost Laptop Study, Ponemon Institute and Intel Corp., Dec. 2010*

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## Data Breach – the Costs

- The cost of cyber crime costs U.S. organizations more than \$3.8 million a year
- The U.S. per record cost of a data breach in 2012 was \$188
- The cost savings from data protection program investments average \$16 million
- The cost of noncompliance is 2.65 times higher than compliance
- Range of loss to individual: \$1,213 - \$975,527

*Sources: 2011 & 2012 Verizon Data Breach Investigation Report; Open Security Foundation, [datalossdb.org](http://datalossdb.org); and 2013 Cost of Data Breach Study, sponsored by Symantec, conducted by Ponemon Institute*

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## Data Breach – the Costs

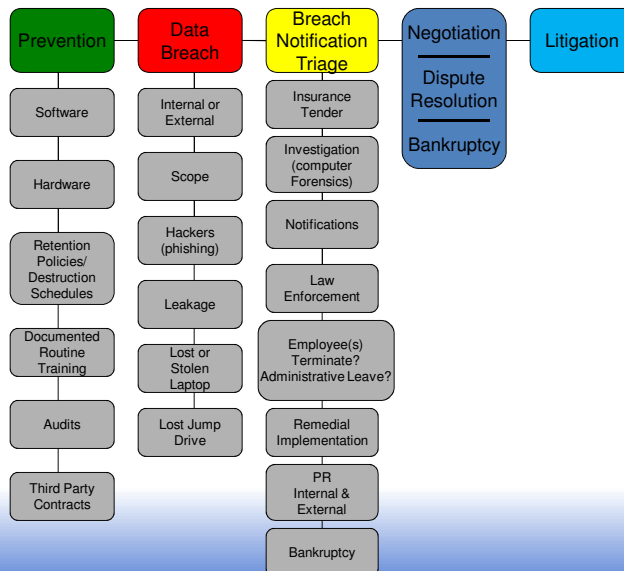
- A typical lost or stolen laptop cost a business an average of \$49,246 due to data breach (80% breach response, 2% laptop replacement)
- Encryption, on average, can reduce the cost of a lost laptop by more than \$20,000

*Sources: The Billion Dollar Lost Laptop Study, Ponemon Institute and Intel Corp., Dec. 2010*

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## Lifecycle of Data & the Security Breach



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## Data Breach – Financial Sector

- In 2011, the average cost per record of a data breach in the financial sector was the third highest at \$247 per record, and 27 percent higher than average
- In 2012, financial services data breaches accounted for 3.8 percent of all data breaches and compromised 470,049 total records
- In 2013 thus far, 3.5 percent of reported data breaches in the U.S. were in the financial services sector.
- Since 2005, 13 percent of data breaches globally were in the financial sector and exposed 256,217,888 records

Source: 2011 Cost of a Data Breach: United States, Ponemon Institute and Symantec, March 2012; ITRC Breach Report, May 2013; A Chronology of Data Breaches, Privacy Rights Clearinghouse, June 2013

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## “IRS Blamed in Massive South Carolina Data Breach”

- So. Carolina Dept. of Revenue employee opened phishing email; hacker captured employee’s username and password
- Hacker installed various malware that captured more user account passwords on 6 servers
- Hacker gained access to three dozen other systems and stole 23 database files
- Data included SSNs for 3.8 million tax filers and information on 1.9 million dependents
- Data included information belonging to 699,900 businesses; 3.3 million bank accounts and 5,000 credit card numbers
- Affected tax payers who filed returns electronically since 1998
- IRS does not require SSNs to be encrypted

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## Personal Identifiable Information (PII)

Individual’s first name or first initial and last name in combination with any one or more of the following:

- Social security number;
- Driver’s license or identification card number;
- Account number, or credit or debit card number in combination with any required security code, access code or password that would permit access to account;

*OR*

- Medical information or health insurance information

Cal. Civ. Code §§ 1798.29; 1798.80 et seq.

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## Data Breach - High Tech Causes

- Malware (Rootkits, Botnets, Viruses, Worms, Spyware . . .)
- Phishing

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## Data Breach - High Tech Causes

**Rootkit:** A set of software tools used by a third party after gaining access to a computer system in order to conceal the altering of files or processes being executed by the third party without the user's knowledge

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## Data Breach - High Tech Causes

**Botnet:** A collection of zombies that are controlled by the same cracker; a collection of compromised computers that is slowly built up then unleashed as a DDOS (Distributed Denial of Service attack) attack or used to send very large quantities of spam

**Zombie:** A computer affected by malware that causes it to do whatever the attacker wants it to do without the user's knowledge

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## Data Breach - High Tech Causes

**Phishing:** The act of sending email that falsely claims to be from a legitimate company. This is usually combined with a threat or request for information, i.e., that an account will close, a balance is due, or information is missing from an account. The email will ask the recipient to supply confidential information, such as bank account details, PINs, passwords, billing/shipping addresses.

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## Data Breach – Low Tech Causes

- Lost or stolen laptops or storage devices
- Credit card “knuckle scraper” papers
- Unsealed envelopes in the mail
- Employees rummaging through files
- Inadvertently including PII on mail merged envelope labels
- Tossing PII without shredding

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## The Patchwork of Laws

### Federal Laws

- Gramm-Leach-Bliley Act of 1999 (GLBA regulated by FTC)
- FTC Standards for Safeguarding Customer Information Rule (16 CFR Pt 314)
- FTC Privacy of Consumer Financial Information Rule (16 CFR Pt 313)
- Federal Credit Reporting Act (FCRA regulated by FTC)
- Fair & Accurate Credit Transactions Act and Red Flags Rules (FACTA regulated by FTC)
- Sarbanes-Oxley Act of 2002 (17 CFR Pts 232, 240, 249)
- Health Insurance Portability and Accountability Act (HIPAA) and the Health Information Technology for Economic and Clinical Health Act (HITECH Act) (regulated by HHS)
- Foreign Intelligence Surveillance Act (FISA)
- Federal Identity Theft and Assumption Deterrence Act

### State Laws for Data Breach Notification

- 46 States and the District of Columbia (7 States added laws within last three years: Alaska, District of Columbia, Iowa, Missouri, South Carolina, Virginia, West Virginia)

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## FTC Standards for **Safeguarding** Customer Information Rule (16 CFR Part 314)

- Financial Institutions, including professional tax preparers, data processors, affiliates, and service providers
- Prohibits unauthorized access to or use of customer records/information that could result in substantial harm or inconvenience to any customer
- Must develop, implement and maintain a written Information Security Program to safeguard sensitive information
- Administrative, technical and physical safeguards

<http://business.ftc.gov/privacy-and-security/gramm-leach-bliley-act>

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## FTC **Privacy** of Consumer Financial Information Rule (16 CFR Part 313)

- Financial Institutions, including professional tax preparers, data processors, affiliates, and service providers
- Must provide customers with privacy notices that explain information collection and sharing practices
- Customers have the right to limit some sharing of their information

<http://business.ftc.gov/privacy-and-security/gramm-leach-bliley-act>

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## California Was the First

In California . . .

- Financial Information Privacy Act (Fin. Code § 4052)
  - GLBA Counterpart
  - Financial Institutions
  - Nonpublic personal information
- Consumer Credit Reporting Agencies Act (Civ. Code §§ 1785.1 *et seq.*)  
FCRA Counterpart
- **Information Practices Act of 1977 (Civ. Code §§ 1798 *et seq.*)**
- Data Breach Notification Law (Civ. Code § 1798.82)

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## Massachusetts Is the Most Stringent

- Data Security Regulations, 201 Code Mass. Regs (CMR) 17.00, effective March 1, 2010
- Businesses must have:
  - Written information security program
  - Heightened security procedures, including encryption
  - Vendor contract provisions mandating compliance
  - \*contracts signed prior to 3/1/10 = 2 yr grace period
  - \*contracts signed after 3/1/10 = no grace period
- Must take “reasonable steps to select and retain third-party providers that are capable of maintaining appropriate security measures”

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## 26 USC § 6713 – Disclosure or Use of Information by Preparers of Returns

### (a) Imposition of penalty

Any person who is engaged in the business of preparing, or providing services in connection with the preparation of, returns of tax, or any person who for compensation prepares any such return for any other person, and

- (1) Discloses any information furnished to him/her for, or in connection with, the preparation of any such return, or
- (2) Uses any such information for any purpose other than to prepare, or assist in preparing, any such return,

Shall pay a (civil) penalty of \$250 for each such disclosure or use, but the total amount imposed within a calendar year shall not exceed \$10,000.

(b) Exceptions. The rules of section 7216(b) shall apply for purposes of this section.

*(See attached statute)*

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## 26 USC § 7216 – Disclosure or Use of Information by Preparers of Returns

- Prescribes a criminal penalty for tax return preparers who knowingly or recklessly disclose or use tax return information for a purpose other than preparing a tax return.
- A violation of Section 7216 is a misdemeanor, with a maximum penalty of up to one year imprisonment or a fine of not more than \$1,000, or both, together with the costs of prosecution.
- Section 6713(a) prescribes a related civil penalty of disclosures and uses that constitute a violation of Section 7216.
- The Gramm-Leach-Bliley Act does not supersede, alter, or affect the requirements of Section 7216, and vice versa.
- Section 7216 applies to disclosures or uses of tax return information occurring on or after January 1, 2009

*(See attached statute)*

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## 26 USC § 7525 – Taxpayer Communications Confidentiality Privilege

- With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.
- **Limitations:**
  - Only in noncriminal tax matters before the IRS; and
  - Only in noncriminal tax proceedings in Federal court brought by or against the United States
  - Does not apply to communications regarding any tax shelters

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## Data Security: Protecting Business Records

1. **Encrypt Data, Mobile Devices, and Storage Devices**
2. **Use Firewalls and Install/Update Anti-Malware Software**
3. **Upgrade Operating Systems and Computers**
4. **Written data protection policies and procedures (develop it, implement it, train users, routinely assess its efficacy, and adjust it)**
5. **Records retention/destruction policy (do not keep records past legal retention requirements and beyond their useful life)**
6. **Shred paper documents as well as electronically stored information (beware . . . “delete” does not necessarily mean delete!)**
7. **Require Strong Passwords/Authentication Solutions: computers, networks, mobile devices (e.g., laptops, iPhones)**
8. **Back up your data for disaster recovery purposes only**
9. **Secure office access and lock filing cabinets**

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## **Data Security: Protecting Business Records**

10. Screen personnel during hiring phase
11. Educate and Train Employees (how to identify confidential information and handle it; beware of emails from unknown users; how to identify a phishing scams; and prohibit/restrict online activities)
12. Require written contracts with vendors, independent contractors (especially IT consultants), cloud computing provider, etc., that impose the same level of safeguards required of you by law (confidentiality provisions may not be enough . . . Include language requiring third parties to ensure information will not be vulnerable to unauthorized access, use or disclosure)
13. Consider representations and warranties of compliance with all privacy and data security laws and indemnification provisions for data breaches (expressly cover all costs associated with response)
14. Consider independent IT/data security audit
15. Document your efforts

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## **Thank You**

If you have any questions . . .

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# Schedule C Due Diligence

IRS/SJSU Small Business Tax Institute  
June 19, 2013



COLLEGE OF BUSINESS AND THE  
LUCAS GRADUATE SCHOOL OF BUSINESS



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## Panelists

- James Counts II, CPA CTFA
- Angie (Ngoc-Thanh) Dang, CPA, Supervisory Revenue Agent – IRS
- Stacey Montes, CPA – Sensiba San Felippo
- Annette Nellen, CPA, Esq. – SJSU MST Program – moderator

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## Agenda

- Define due diligence
- IRS 2013 filing season focus on Schedule C
- Avoiding 6662 and 6694 penalties
- Form 8867 and extra due diligence if EITC claimant has a Schedule C
- Hobby v business reminders
- Gross receipts reminders
- Deductions
- Depreciation
- Home office
- Real estate professional under 469(c)(7)
- Self-employment tax reminders
- Key federal-CA differences to not overlook regarding Schedule C
- When is business owner required to issue 1099s
- Worker classification and compliance
- Mobile workforce considerations
- IRS audit considerations
- Getting more information from IRS

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## Due diligence requirements for tax return preparers

- “In general, tax return preparers should understand the underlying substantive law affecting an item of income or deduction. Tax return preparers must exercise due diligence in preparing or assisting in the preparation, approval, and filing of returns, documents, affidavits, or other papers relating to IRS matters. Tax return preparers also must exercise due diligence in determining (1) the correctness of oral and written representations made by the tax return preparer to the IRS, and (2) the correctness of representations made by the tax return preparer to the client with reference to any matter administered by the IRS. Tax return preparers who prepare returns for taxpayers who may be eligible for the earned income tax credit have additional due diligence requirements.”

Excerpt from FAQ on IRS visits to selected preparers –

<http://www.irs.gov/Tax-Professionals/IRS-Letters-and-Visits-to-Return-Preparers-FAQs>

Annette Nellen, SJSU MST Program

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## IRS Letters and Visits - Letter 5102

**Note: The following is the text of Letter 5102 the IRS sent out to selected tax return preparers nationwide in January 2013.**

We reviewed tax returns you prepared in the past year and found that many have a high percentage of traits we believe typically indicate errors on Form 1040, Schedule C, Profit or Loss from Business (Sole Proprietorship). You may benefit from continuing education (CE) programs on this topic.

As part of your CE requirement, we recommend you take a minimum of 4 hours of programs related to business income and expenses. Information about CE requirements and a list of IRS-approved CE providers is available at [IRS.gov/taxpros/ce](http://IRS.gov/taxpros/ce).

When you prepare returns during the next filing season, please pay special attention to your work on Schedule C returns to ensure you prepare them accurately. In particular, make sure you are familiar with the following areas.

### **Due diligence responsibilities**

A paid tax return preparer must take multiple steps to prepare accurate tax returns on behalf of clients. These steps are a preparer's due diligence and include reviewing the applicable tax law to establish the relevance and reasonableness of income, credits, expenses, and deductions on a return. In general, you can rely in good faith without verification on information your client provides. However, you can't ignore the implications of the information you have. You must make reasonable inquiries if the information appears to be incorrect, inconsistent, or incomplete.

### **Schedule C reminders**

To prepare an accurate Schedule C, you must ask your clients relevant and probing questions to help you determine if the expenses are allowable. Taxpayers may not fully understand the tax laws and may incorrectly believe they can claim deductions for non-qualifying expenses. You should also ask your clients if they have receipts to support the expenses and instruct them to keep them in case we request supporting documents.

### **Helpful resources**

We provide information about the Schedule C on our website at [IRS.gov](http://IRS.gov), keyword: Recommended Reading for Small Businesses. In addition, we recommend you review:

- Schedule C instructions
- Circular 230, Section 10.22, Diligence as to accuracy
- Circular 230, Section 10.34, Standards with respect to tax returns and documents, affidavits, and other papers

### **Potential consequences**

In the future, both you and your clients could face negative consequences from inaccurate returns. We will check to see if you complete the continuing education on business income and expenses, and we'll be looking for improvements in future returns you prepare. Inaccurate returns may result in any of the following consequences:

- If we examine your clients' returns and find inaccuracies, your clients may be liable for additional tax, interest, additions to tax, and penalties.
- If you prepare a client return that has an understatement of tax liability due to an unreasonable position, we can assess you a minimum penalty of \$1,000 per return (IRC Section 6694(a)).
- If you prepare a client return that has an understatement of tax liability due to reckless or intentional disregard of rules or regulations by the tax preparer, we can assess a minimum penalty of \$5,000 per return (IRC section 6694(b)).

I hope this letter and your continuing education focus on Schedule C preparation will heighten your awareness of your responsibilities and help ensure you prepare accurate Schedules C for your clients.

Thank you for your cooperation.

Sincerely,

Carol A. Campbell  
Director, Return Preparer Office

*Page Last Reviewed or Updated: 2013-01-09*

## IRS letter to preparers in 2012/2013

Program reached about 4,000 preparers.

Per IRS:

### **“Due diligence responsibilities**

A paid tax return preparer must take multiple steps to prepare accurate tax returns on behalf of clients. These steps are a preparer’s due diligence and include reviewing the applicable tax law to establish the relevance and reasonableness of income, credits, expenses, and deductions on a return. In general, you can rely in good faith without verification on information your client provides. However, you can’t ignore the implication of the information you have. You must make reasonable inquiries if the information appears to be incorrect, inconsistent or incomplete.”

<http://www.irs.gov/Tax-Professionals/IRS-Letters-and-Visits-to-Return-Preparers>

## Circular 230 - §10.22 Diligence as to accuracy

- “(a) *In general.* A practitioner must exercise due diligence —
  - (1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;
  - (2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and
  - (3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service.”

## Circular 230, §10.34(d) - Relying on information furnished by clients

- “A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.”

## SSTS No. 3, *Certain Procedural Aspects of Preparing Returns* (AICPA)

- “In preparing or signing a return, a member may in good faith rely, without verification, on information furnished by the taxpayer or by third parties. However, a member should not ignore the implications of information furnished and should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to the member. Further, a member should refer to the taxpayer’s returns for one or more prior years whenever feasible.”
- Similar to Rev. Proc. 80-40 on avoiding §6694 preparer penalty.

## Due diligence steps

- Exercise it in identifying and understanding client facts and application of tax rules.
- Know your clients
  - Learn about background and new activities.
- Think broadly – anything look or sound odd?
- Check current return against prior years.
- Use practices that aid compliance (checklists, research tools and skills, proper and updated software tools, “tickler” systems, etc.).
- Keep up to date on changes to tax rules.

## Avoiding §6662 and §6694 Penalties



- §6662 Imposition of accuracy-related penalty on underpayments
- §6694 Understatement of taxpayer's liability by tax return preparer

Text included in your materials.



### **§6662 Imposition of accuracy-related penalty on underpayments**

- (a) Imposition of penalty. If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.
- (b) Portion of underpayment to which section applies. This section shall apply to the portion of any underpayment which is attributable to 1 or more of the following:
  - (1) Negligence or disregard of rules or regulations.
  - (2) Any substantial understatement of income tax.
  - (3) Any substantial valuation misstatement under chapter 1.
  - (4) Any substantial overstatement of pension liabilities.
  - (5) Any substantial estate or gift tax valuation understatement.
  - (6) Any disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law.
  - (7) Any undisclosed foreign financial asset understatement.

This section shall not apply to any portion of an underpayment on which a penalty is imposed under section 6663 . Except as provided in paragraph (1) or (2)(B) of section 6662A(e) , this section shall not apply to the portion of any underpayment which is attributable to a reportable transaction understatement on which a penalty is imposed under section 6662A .

- (c) Negligence. For purposes of this section, the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term "disregard" includes any careless, reckless, or intentional disregard.

- (d) Substantial understatement of income tax.

#### **(1) Substantial understatement.-**

(A) In general. For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of-

- (i) 10 percent of the tax required to be shown on the return for the taxable year, or
- (ii) \$5,000.

(B) Special rule for corporations. In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of-

- (i) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, \$10,000), or
- (ii) \$10,000,000.

#### **(2) Understatement.**

(A) In general. For purposes of paragraph (1), the term "understatement" means the excess of-

- (i) the amount of the tax required to be shown on the return for the taxable year, over

- (ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).

The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies.

(B) Reduction for understatement due to position of taxpayer or disclosed item. The amount of the understatement under subparagraph (A) shall be reduced by that portion of the understatement which is attributable to-

- (i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or

- (ii) any item if-

- (I) the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return, and

- (II) there is a reasonable basis for the tax treatment of such item by the taxpayer.

For purposes of clause (ii)(II), in no event shall a corporation be treated as having a reasonable basis for its tax treatment of an item attributable to a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation.

(C) Reduction not to apply to tax shelters.

- (i) In general. Subparagraph (B) shall not apply to any item attributable to a tax shelter.

- (ii) Tax shelter. For purposes of clause (i), the term "tax shelter" means-

- (I) a partnership or other entity,

- (II) any investment plan or arrangement, or

- (III) any other plan or arrangement,

- if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

(3) Secretarial list. The Secretary may prescribe a list of positions which the Secretary believes do not meet 1 or more of the standards specified in paragraph (2)(B)(i) section 6664(d)(2), and section 6694(a)(1) . Such list (and any revisions thereof) shall be published in the Federal Register or the Internal Revenue Bulletin.

(e) Substantial valuation misstatement under chapter 1.

[not printed]

(f) Substantial overstatement of pension liabilities.

[not printed]

(g) Substantial estate or gift tax valuation understatement.

[not printed]

(i) Increase in penalty in case of nondisclosed noneconomic substance transactions.

[not printed]

(j) Undisclosed foreign financial asset understatement.

[not printed]

## **§6694 Understatement of taxpayer's liability by tax return preparer**

(a) Understatement due to unreasonable positions.

(1) In general.

If a tax return preparer-

(A) prepares any return or claim of refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2), and

(B) knew (or reasonably should have known) of the position,

such tax return preparer shall pay a penalty with respect to each such return or claim in an amount equal to the greater of \$1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) Unreasonable position.

(A) In general. Except as otherwise provided in this paragraph, a position is described in this paragraph unless there is or was substantial authority for the position.

(B) Disclosed positions. If the position was disclosed as provided in section 6662(d)(2)(B)(ii)(I) and is not a position to which subparagraph (C) applies, the position is described in this paragraph unless there is a reasonable basis for the position.

(C) Tax shelters and reportable transactions. If the position is with respect to a tax shelter (as defined in section 6662(d)(2)(C)(ii)) or a reportable transaction to which section 6662A applies, the position is described in this paragraph unless it is reasonable to believe that the position would more likely than not be sustained on its merits.

(3) Reasonable cause exception. No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.

(b) Understatement due to willful or reckless conduct.

(1) In general.

Any tax return preparer who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a conduct described in paragraph (2) shall pay a penalty with respect to each such return or claim in an amount equal to the greater of-

(A) \$5,000, or

(B) 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) Willful or reckless conduct.

Conduct described in this paragraph is conduct by the tax return preparer which is-

(A) a willful attempt in any manner to understate the liability for tax on the return or claim, or

(B) a reckless or intentional disregard of rules or regulations.

(3) Reduction in penalty.

The amount of any penalty payable by any person by reason of this subsection for any return or claim for refund shall be reduced by the amount of the penalty paid by such person by reason of subsection (a).

(c) Extension of period of collection where preparer pays 15 percent of penalty.

(1) In general. If, within 30 days after the day on which notice and demand of any penalty under subsection (a) or (b) is made against any person who is a tax return preparer, such person pays an amount which is not less than 15 percent of the amount of such penalty and files a claim for refund of the amount so paid, no levy or proceeding in court for the collection of the remainder of such penalty shall be made, begun, or prosecuted until the final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding the provisions of section 7421(a), the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court. Nothing in this paragraph shall be construed to prohibit any counterclaim for the remainder of such penalty in a proceeding begun as provided in paragraph (2).

(2) Preparer must bring suit in district court to determine his liability for penalty. If, within 30 days after the day on which his claim for refund of any partial payment of any penalty under subsection (a) or (b) is denied (or, if earlier, within 30 days after the expiration of 6 months after the day on which he filed the claim for refund), the tax return preparer fails to begin a proceeding in the appropriate United States district court for the determination of his liability for such penalty, paragraph (1) shall cease to apply with respect to such penalty, effective on the day following the close of the applicable 30-day period referred to in this paragraph .

(3) Suspension of running of period of limitations on collection. The running of the period of limitations provided in section 6502 on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Secretary is prohibited from collecting by levy or a proceeding in court.

(d) Abatement of penalty where taxpayer's liability not understated. If at any time there is a final administrative determination or a final judicial decision that there was no understatement of liability in the case of any return or claim for refund with respect to which a penalty under subsection (a) or (b) has been assessed, such assessment shall be abated, and if any portion of such penalty has been paid the amount so paid shall be refunded to the person who made such payment as an overpayment of tax without regard to any period of limitations which, but for this subsection, would apply to the making of such refund.

(e) Understatement of liability defined. For purposes of this section, the term "understatement of liability" means any understatement of the net amount payable with respect to any tax imposed by this title or any overstatement of the net amount creditable or refundable with respect to any such tax. Except as otherwise provided in subsection (d), the determination of whether or not there is an understatement of liability shall be made without regard to any administrative or judicial action involving the taxpayer.

(f) Cross reference. For definition of tax return preparer, see section 7701(a)(36).

## §6662(b) [client penalties]



- (b) Portion of underpayment to which section applies:
- (1) **Negligence or disregard of rules or regulations.**
  - (2) **Any substantial understatement of income tax.**
  - (3) Any substantial valuation misstatement under chapter 1.
  - (4) Any substantial overstatement of pension liabilities.
  - (5) Any substantial estate or gift tax valuation understatement.
  - (6) Any disallowance of claimed tax benefits by reason of a transaction lacking economic substance
  - (7) Any undisclosed foreign financial asset understatement.

## §6662(c)



- (c) Negligence - "negligence" includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term "disregard" includes any careless, reckless, or intentional disregard.

## §6662(d)



### (d) Substantial understatement of income tax

- (1) Substantial understatement
  - if the amount of the understatement exceeds the greater of -
    - (i) 10 percent of the tax required to be shown on the return for the taxable year, or
    - (ii) \$5,000.

## §6694 Preparer penalty overview



- Applicable if “understatement due to unreasonable positions”
  - “Tax return preparer”
  - Prepares any return or refund claim with an “understatement of liability”
  - And any part of that understatement is due to an “unreasonable position”
  - And preparer knew or reasonably should have known of the position,
  - Then penalty applies.
  - Higher penalty if understatement due to willful or reckless conduct.

## Amount of §6694 penalty



- General:
  - Greater of \$1,000 or 50% of “income derived (or to be derived) by the preparer wrt the return or claim for refund”
- Willful or reckless conduct
  - Same as above only replace \$1,000 with \$5,000

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## Avoiding §6662 and §6694 Penalties



- Have substantial authority for all positions taken on the return.
- If do not have substantial authority, but have reasonable basis, disclose.
  - Form 8275, Disclosure Statement
  - Form 8275-R, Regulation Disclosure Statement
  - Annual Revenue Procedure – return disclosure
    - Rev. Proc. 2012-15
      - <http://www.irs.gov/pub/irs-drop/rp-12-15.pdf>
    - Rev. Proc. 2012-51
      - [http://www.irs.gov/irb/2012-51\\_IRB/ar14.html](http://www.irs.gov/irb/2012-51_IRB/ar14.html)

See definition of terms in Code and regs.

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## Due Diligence If EITC and A Business



Question 27: If a Schedule C is included with this return, which documents or other information, if any, did you rely on to confirm the existence of the business and to figure the amount of Schedule C income and expenses reported on the return? Check all that apply. **Keep a copy of any documents you relied on.** See the instructions before answering.

- A No Schedule C
- B Business license
- C Forms 1099s
- D Records of gross receipts provided by taxpayer
- E Taxpayer summary of income
- F Records of expenses provided by taxpayer
- G Taxpayer summary of expenses
- H Bank statements
- I Reconstruction of income and expenses
- J Other \_\_\_\_\_
- K Did not rely on any documents, but made notes in file
- L Did not rely on any documents

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## Due Diligence If EITC and A Business



Form **8867**  
Department of the Treasury  
Internal Revenue Service

Paid Preparer's Earned Income Credit Checklist

► To be completed by preparer and filed with Form 1040, 1040A, or 1040EZ.  
► Information about Form 8867 and its separate instructions is at [www.irs.gov/form8867](http://www.irs.gov/form8867).

### Instructions for Line 27

**You must keep copies of any documents provided by the taxpayer that you relied on to determine whether any child is a qualifying child.**

#### Document Retention

You must keep the records described in 4a, 4b, 4c, 4d, and 4e of page 4 of Form 8867 for 3 years from the latest of the following dates that apply.

The due date of the tax return (not including extensions).

The date the return was filed (if you are a signing tax return preparer electronically filing the return).

IRS resources - <http://www.eitc.irs.gov/rptoolkit/dd/lawandregs/>

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## Hobby vs. Business



Meet the requirements of:

IRC 162 – carrying-on a trade or business

or

IRC 212 – for the production of income

## Hobby vs. Business Reg. § 1.183-2(b)



- Manner
- Expertise
- Time and effort
- Expect assets may appreciated
- The success in other business
- History of income or losses
- The amount of occasional profits
- Financial status
- Element of personal pleasure

# Hobby vs. Business IRC § 183(d) Presumption

3 out of 5



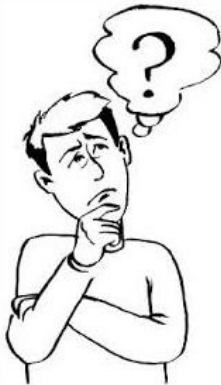
2 out of 7



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## Postpone Determination?



File Form 5213

Angie Dang, CPA, Supervisory Revenue Agent – IRS, San Jose

**5213** Election To Postpone Determination as to Whether the Presumption Applies That an Activity is Engaged in for Profit

OMB No. 1545-0045

Department of the Treasury Internal Revenue Service

▶ To be filed by individuals, estates, trusts, partnerships, and S corporations.

Identifying number as shown on tax return

Address (number and street, apt. no., tract name or P.O. box, number if mail is not delivered to street address)

City, town or your office, state, and ZIP code

The taxpayer named above elects to postpone a determination as to whether the presumption applies that the activity described below is engaged in for profit. The determination is postponed until the close of:

- The 6th tax year for an activity that consists mainly of breeding, training, showing, or racing horses or
- The 4th tax year for any other activity.

after the tax year in which the taxpayer first engaged in the activity.

1 Type of taxpayer engaged in the activity (check the box that applies):

Individual  Partnership  S corporation  Estate or trust

2a Description of activity for which you elect to postpone a determination

2b First tax year you engaged in activity described in 2a

Under penalty of perjury, I declare that I have examined this election, including accompanying schedules, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of taxpayer or fiduciary \_\_\_\_\_ Date \_\_\_\_\_

Signature of taxpayer's spouse, if joint return was filed \_\_\_\_\_ Date \_\_\_\_\_

Signature of general partner authorized to sign partnership return \_\_\_\_\_ Date \_\_\_\_\_

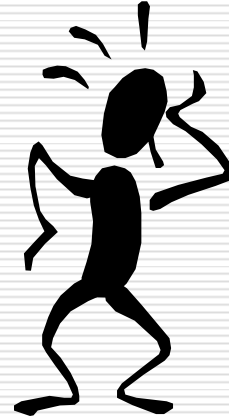
Signature and title of officer, if an S corporation \_\_\_\_\_ Date \_\_\_\_\_

For Privacy Act and Paperwork Reduction Act Notice, see Instructions on back. OMB No. 1545-0045 Form 5213 (Rev. 2/2005)

## Hobby Loss Allocation

Order of deduction:

1. Otherwise Deductible:  
mortgage interest, property taxes, etc.
2. Expenses limited to related hobby income:
  - (a) Business expenses
  - (b) Basis Adjustments:  
Depreciation & amortization



## Sch C Gross Receipts Reminders

- Method of accounting
  - Cash – anything rec'd in form of cash, property or services? When? Constructive receipt?
  - Accrual – all events test
  - Prepayments – generally taxable when received
    - Be sure not a true deposit (not income).
    - May be able to defer prepayments if use accrual and adopt Rev. Proc. 2004-34
- Check 1099s
  - Also ask about jobs where no 1099 received.
  - Compare reported gross receipts to Form 1099-K amount (credit or debit card or Paypal revenues).

# Deductions



## Property Tax Accounting

FTB - "Understanding the Real Estate Tax Deduction"  
[https://www.ftb.ca.gov/individuals/Real\\_Estate\\_Tax\\_Deduction/index.shtml](https://www.ftb.ca.gov/individuals/Real_Estate_Tax_Deduction/index.shtml)

Explains what is and is not deductible for property taxes.

## California Property Taxes

Becomes a lien on January 1<sup>st</sup>, prior to fiscal year for property taxes (which is July 1 thru June 30). Taxes due December 10<sup>th</sup> and April 10<sup>th</sup> during fiscal year.

- Example: January 1, 2013 the property taxes are a lien for the taxes due for July 1, 2013 thru June 30, 2014. These taxes are payable on December 10, 2013 and April 10, 2014.

Taxpayer must be beneficial or equitable owner of the property per state law. The benefits and burdens of the property must have passed to taxpayer paying the taxes whether title has passed to taxpayer or not.

For cash basis taxpayers, tax is deductible when paid and for accrual basis taxpayers property tax is deductible when accrued.

# Deductions



## Recordkeeping for business vs. personal

**Personal Recordkeeping** – taxpayers need documentation on items that qualify for and they actually claim on their returns. They need to maintain documentation to support the who, what, when and where and how paid. For funds and other assets received the taxpayer should maintain support for all funds / assets received whether the funds /assets are income or not income required to be reported on their tax returns.

**Business Recordkeeping** – Many small business owners do not understand the need to maintain proper records and what is required for proper records for taxes.

## Deductions



Other expenses – look at and question types of expenses the client may show

Vehicle expenses – common audit adjustment because client does not have required documentation on miles driven.

Ask client what type of records they have for mileage use.  
Ask questions about what they are claiming for vehicle miles driven and actual expenses on the vehicles.

## IRS information on deductions



Pub 583 Starting A Business and Keeping Records  
Pub 463 Travel, Entertainment, Gift, and Car Expenses  
Pub 587 Business Use of Your Home  
Pub 535 Business Expenses  
Pub 334 Tax Guide for Small Business  
Pub 1544 Reporting Cash Payments of Over \$10,000

If they have or will soon have payroll:

Pub 15 (Circular E), Employer's Tax Guide  
Pub 15A Employer's Supplemental Tax Guide  
Pub 15B Employer's Tax Guide to Fringe Benefits



## Bonus Depreciation

-50% bonus currently available for assets used in a trade or business

- must be NEW assets
- must be placed in service before January 1, 2014
- must utilize MACRS depreciation method

Note: may create a taxable loss that can be carried back/forward

CA non-conformity: no bonus depreciation available

Must ELECT OUT of bonus depreciation by asset life class



## §179 depreciation

- Election to expense capitalized asset costs
- Applies to:
  - Tangible, personal property (section 1245 property) used in a trade or business
  - New AND used assets
- Limitations 2012/2013:
  - \$500,000/year; reduces dollar for dollar after \$2M in purchases for the year
  - CA non-conformity-\$25k maximum 179/year; reduces dollar for dollar after \$200k in purchases



## §179 and automobiles

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- Can only elect 179 on an auto if:
  - Auto used at least 50% for business AND
  - Gross vehicle weight greater than 6,000 lbs.
- Election for an auto is limited to \$25,000 maximum section 179 depreciation
- Note: Bonus depreciation is also disallowed for autos if 50% business use is not met.



## §179 hidden traps

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- 179 depreciation is limited to taxable income
  - If you create a loss, section 179 election amount is carried forward and utilized based on maximum annual election allowed.
  - Purchase phase-out also applies to taxpayer. If own multiple businesses, need to aggregate gross purchases from all entities to determine phase-out.
  - Maximum election amount limited on individual returns; pass-through entity elections exceeding these limits could limit overall deductions in current/future tax periods.



## Qualified leasehold improvements

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### Defined:

- improvement to interior of non-residential building
- improvement in service more than 3 years after building originally placed in service
- improvement cannot relate to elevator/escalator, enlargement of a building structural components benefitting common areas or the internal structural framework of the building
- must be pursuant to a lease where there is no significant related parties (IRC Section 168(k)(3))



## Benefits of Qualified Leasehold Improvements

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- 15 year life (vs. 39 year life)
- Qualifies for 50% bonus if placed in service before 1/1/2014
- Qualifies for §179 depreciation under qualified real estate provisions
  - Can elect to expense up to \$250k/year with reduction in maximum after qualifying purchases exceed \$500k.



## FIXED ASSET INPUT SHEET

### Fixed Asset Terms In Years

	Section	SL	MACRS	200DB	MACRS150	MACRS150
<b>1994 and beyond</b>	179	Book	Federal	State	AMT	ACE <sup>1</sup>
Furniture, Fixtures and Equipment <sup>4</sup>	Yes	7	7	7	7	7
Computer Equipment	Yes	5	5	5	5	5
Software (amortized straight-line)	Yes	3	3	3	3	3
Cars and trucks <sup>5</sup>		5	5	5	5	5
Building <sup>2</sup>	No	40	39	39	39	39
Leasehold improvements <sup>3</sup>	No	Lease term	39	39	39	39
Qualified Leasehold Improvements <sup>6</sup>	Yes	Lease term	15	39	15	15

<sup>1</sup> ACE no longer applies to fixed asset additions. For companies that started prior to with ACE adjustments, we should still enter the ACE columns in CS. These columns should tie exactly to the AMT column.

<sup>2</sup> Buildings and leaseholds that are residential rentals are 27.5 for federal and state purposes. 39 yr. is for nonresidential real estate.)

<sup>3</sup> "Qualified leasehold improvements" placed in service after October 22, 2004 and before January 1, 2014 is a 15-year straight-line property with 15-year recover period. Special rules also apply to restaurant improvements. Please see the tax department if you have these additions in your return.

<sup>4</sup> Construction equipment qualifies for a 5 year recovery period.

<sup>5</sup> Federal Automobile Depreciation Limits:

Luxury autos only. A vehicle is considered a luxury auto if the gross vehicle weight is less than 6,000 pounds. See [www.intellichoice.com](http://www.intellichoice.com) to determine which vehicles qualify.

Year of acquisition	Type	Year 1	Year 2	Year 3	Year 4 onwards
2013	Passenger	\$ 3,160	\$ 5,100	\$ 3,050	\$ 1,875 (plus \$8k if bonus)
	Trucks/Vans	\$ 3,360	\$ 5,400	\$ 3,250	\$ 1,975 (plus \$8k if bonus)
2012	Passenger	\$ 3,160	\$ 5,100	\$ 3,050	\$ 1,875 (plus \$8k if bonus)
	Trucks/Vans	\$ 3,360	\$ 5,300	\$ 3,150	\$ 1,875 (plus \$8k if bonus)

<sup>6</sup> Must meet criteria of "Qualified leasehold improvement":

1-improvement to the interior of non-residential building

2-improvement in service more than 3 years after the building was originally placed in service

3-improvement cannot relate to elevator/escalator, enlargement of a building, structural components benefitting common areas or the internal structural framework of the building

4-must be pursuant to a lease where there is no significant related parties (IRC Section 168(k)(3))

Status set to expire beginning 1/1/2014.

**Bonus Depreciation (Federal only)**

- 30% bonus depreciation on assets placed in service from 9/11/01 - 5/5/03
- 50% bonus depreciation on assets placed in service from 5/6/03 - 12/31/04
- 50% bonus depreciation on assets placed in service from 1/1/08 - 9/9/10
- 100% bonus depreciation on assets placed in service from 9/9/10 - 12/31/11
- 50% bonus depreciation on assets placed in service from 1/1/12 - 12/31/13
- Applies to MACRS depreciation methods only

**NOTE: bonus cannot be utilized on used assets**

**Section 179 Depreciation**

1. The section 179 expense provision only applies to section 1245 property, tangible, depreciable, personal property. It does not apply to section 1250 property, depreciable real property, except as described below. It also does not apply to intangibles such as goodwill, or organizational costs. It is limited to taxable income and is as follows:

**179 Tip - 179 can be utilized on used assets**

	2008	\$250,000 (phase out for purchases >\$800k)	
	2009	\$250,000 (phase out for purchases >\$800k)	
	2010	\$500,000 (phase out for purchases >\$2M)	
Qualified real property	2010	\$250,000 (phase out for purchases >\$500k)	
	2011	\$500,000 (phase out for purchases >\$2M)	
Qualified real property	2011	\$250,000 (phase out for purchases >\$500k)	<b>Note 1</b>
	2012	\$500,000 (phase out for purchases >\$2M)	
Qualified real property	2012	\$250,000 (phase out for purchases >\$500k)	<b>Note 1</b>
	2013	\$500,000 (phase out for purchases >\$2M)	
Qualified real property	2013	\$250,000 (phase out for purchases >\$500k)	<b>Note 1</b>

**Please also note** that vehicles placed in service after October 22, 2004 with GVW between 6,000 and 14,000 pounds are subject to a Section 179 limit of \$25,000.

**California:** limited to \$25,000 (phase out for purchases >\$200k)

**Note 1:**

Must be qualified leasehold improvement property, qualified restaurant property, qualified retail improvement property acquired for use in the active conduct of a trade or business and can't be certain ineligible property (i.e used for lodging, used outside the U.S., used by governmental units, foreign persons or entities, and certain tax-exempt organizations, air conditioning or heating units.)

Prepared by Stacey Montes, Sensiba San Felippo

# Home Office Audit Issues

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## Type of business



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# Home Office Audit Issues

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- % calculation
- Direct vs. Indirect Expenses-Document
- Exclusive and regular use
- Limitation

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# Home Office – New Safe Harbor



## Rev. Proc. 2013-13

[http://www.irs.gov/irb/2013-13\\_IRB/index.html](http://www.irs.gov/irb/2013-13_IRB/index.html)

Taxpayers that qualify for office in home can elect a safe harbor method to compute deduction. Square footage of office is limited to 300 square feet and current rate (which the IRS might change from time to time) is \$5.00 per square foot. This rate covers both direct and indirect expenses of the office in home.

Election made on timely filed return and on original federal income tax return.

Election can be made year by year.

Election once made is irrevocable.

Schedule A deductible items that could be a portion of the office in home deduction are still allowable in full on Schedule A.

Each spouse may make the election if they qualify but not on the same 300 square feet.

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# Real Estate Professional - Compliance



- Real Estate Professionals must meet both of the following criteria to qualify (IRC Sec. 469(c)(7)(B)):
  - Taxpayer performs >50% of all personal services in trade or business activities in real property trade and business activities (where the taxpayer materially participates) AND
  - Taxpayer performs more than 750 hours in real property trade or business activities with material participation

**Why?** Rental real estate activities are “passive” by definition

- Passive income can only be offset by passive losses
- If losses are non-passive, they can offset all types of income (including wages, investment income, etc.)

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## Material Participation

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- Material participation is met (for a single activity) if any one of the following is met:
  - 1-Taxpayer performs more than 500 hours in the activity for the year
  - 2-"substantially all" criteria
  - 3->100 hour test
  - 4-Significant Participant Activity test: 500 hours in >100 hour activities
  - 5-Prior year material participation test (material in 5 of last 10 years)
  - 6-Personal service activity test: (any 3 prior years met)
  - 7-Facts and circumstances: participation is regular, substantial & continuous (still need at least 100 hours)



## Material Participation: considerations

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- Limited partners are generally not considered to materially participate (need to meet tests 1,5, or 6)
- Material participation of spouse is deemed material participation of the taxpayer as well [IRC Sec. 469\(h\)\(5\)](#)



## Rental real estate-exception

- Passive losses from rental real estate are only deductible against passive income.
- \$25,000 is allowed to be deducted in any year where modified AGI does not exceed \$100k.
- If a taxpayer exceeds limit, 50% reduction in \$25k loss allowed for excess modified AGI.
- **REQUIRED** to use exception:
  - Need to “actively participate” to qualify (make management decisions).
  - Need to own at least 10% of the rental activity (not through a limited partnership ownership).

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## Election to aggregate rental activities

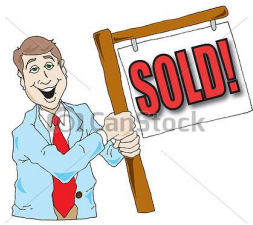
- To qualify as a real estate professional who manages many rental properties, it may be difficult to qualify  
Can elect to aggregate the rental activities into one activity:
  - can elect in any year; election pursuant to section 469(c)(7)(A)
  - election irrevocable unless significant change in facts and circumstances
  - done on a case by case basis

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# Real Estate Professional Audit Issues

Grouping  
Passive vs. Non-passive  
Material participation



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## Not Every Hour Counts!

### Material Participation Is NOT . . .





Work not customarily done by an owner  
and a principal purpose is to avoid § 469.  
Participation as an “Investor”

Passive loss limitations are applied at 1040  
level.

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# Documentation! Documentation!

-  SPECIFIC DATE
-  DESCRIPTION OF ACTIVITIES
-  HOURS FOR THOSE ACTIVITIES
-  DOCUMENTATION (calendar, etc)



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## Self-Employment Tax Reminders



Special rules apply to following types of taxpayers as to if they are or are not required to pay SE Tax:

- Aliens
- Children employed by parent
- Church employee
- Fishing crew member
- Notary public
- State or local government employee
- Foreign government or international organization employee
- U.S. citizen or resident alien residing abroad

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## Self-Employment Tax Reminders



If a taxpayer has more than one trade, business or profession they may combine them (whether a profit or loss on each).

### More:

<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Self-Employment-Tax-%28Social-Security-and-Medicare-Taxes%29>

<http://www.irs.gov/publications/p334/ch10.html>

## Self-Employment Tax Reminders



### SE Tax Non-Farm Optional Method and Farm Optional Method

These two methods may be of a benefit to the taxpayer. Using one or both of these methods may either increase or decrease the total tax due on their income tax return.

Reasons to use one of these options are:

- Greater credit for Social Security benefits,
- May increase your child or dependent care credit,
- May qualify them for EITC or increase the amount of EITC,
- May qualify them for or increase the additional child tax credit.



## New Health Care Act: .9% Medicare Tax

- Taxed on earned income (wage or self-employment income).
- .9% Medicare tax threshold:
  - \$250k – Married filing joint
  - \$125k – Married filing separate
  - \$200k – any other status
- Employers required to withhold in the pay period that wage will exceed the \$200k threshold
- Not deductible as self employment tax (IRC Section 164(f)(1)).
- Required to be included in estimated taxes for the year to avoid underpayment penalties.



## Federal vs. CA differences – Schedule C

- CA taxes on worldwide income
- CA does not allow the following:
  - Bonus depreciation
  - 179 in excess of \$25k (with \$200k purchase cap phase-out)
  - 179 for off the shelf software purchases
  - 15 year life for qualified leasehold improvements
- Cell phones – still treated as listed property for CA
- DPAD – no similar deduction
- CA EZ credits/deductions and related reduction in asset basis for EZ credit

## When is Business Owner Required to Issue Form 1099?



File Form 1099-MISC, Miscellaneous Income, for each person to whom you have paid during the year:

At least \$10 in royalties (see the instructions for box 2) or broker payments in lieu of dividends or tax-exempt interest (see the instructions for box 8);

At least \$600 in rents, services (including parts and materials), prizes and awards, other income payments, medical and health care payments, crop insurance proceeds, cash payments for fish (or other aquatic life) you purchase from anyone engaged in the trade or business of catching fish, or, generally, the cash paid from a notional principal contract to an individual, partnership, or estate;

Any fishing boat proceeds; or

Gross proceeds of \$600 or more paid to an attorney even if a corporation.

In addition, use Form 1099-MISC to report that you made direct sales of at least \$5,000 of consumer products to a buyer for resale anywhere other than a permanent retail establishment. You must also file Form 1099-MISC for each person from whom you have withheld any federal income tax under the backup withholding rules regardless of the amount of the payment.

See IRC Section 6041.

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## Worker Classification



- **Independent contractor:** individual contracted to perform and control the work they do (controlling “what will be done” and “how it will be done”)

versus

- **Employee:** individual hired to perform services where employer controls what work is done and how it is done

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## Why relevant?

- Employers required to withhold employment taxes and remit withholding on a regular basis (monthly or semi-weekly).
- Federal taxes include federal income tax, social security, Medicare and Federal Unemployment Tax.
- Filing Form 940 annually, Form 941 quarterly, Forms W-2/W-3 annually.
- Similar CA reporting required.
- Penalties and interest for non-compliance.



## Distinguishing Between the Two

- Facts and circumstance support the classification:
  - Behavioral: who controls what and how work is done?
  - Financial: What financial factors are controlled by worker vs. employee?
  - Type of relationship: Any written contracts? What are the terms? Are employee type benefits available? Is the relationship ongoing? Is the work done key to business operations?

<http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-%28Self-Employed%29-or-Employee%3F>



## IRS Voluntary Classification Settlement Program (VCSP)

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- Optional program to obtain some relief when a taxpayer needs to reclassify independent contractors as employees for future tax periods
- Eligibility:
  - Must have consistently treated workers as independent contractors and filed all required 1099 forms for the 3 prior tax years
  - Cannot be under a current employment tax audit
  - If a prior employment audit occurred, must be in compliance with results



## VCSP continued

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### Participants must:

- Pay 10% of the employment tax liability that would have been due in the most recent tax year

### Benefits:

- Participants are NOT liable for interest and penalties on the 10% employment tax liability paid
- Participants are NOT subject to an employment tax audit related to the workers reclassified under the program



## Applying for VCSP

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- File Form 8952 at least 60 days prior to the date requesting reclassification as employees
- May also file Form 2848 Power of Attorney
- Must make full payment of balance due on reclassification under the final closing agreement with the IRS
- Also a VCSP TEE until June 30, 2013 for non-1099 compliance:
  - Pay 25% of the liability
  - Pay a reduced graduated penalty for unfiled Forms 1099 for prior three years
  - Must file 3 prior years of 1099s

<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Voluntary-Classification-Settlement-Program>



## Mobile workforce Considerations

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- Individuals can be taxed in different states when performing employment duties
- Withholding may be required
- Employers and employees may have tax obligations
- Compliance difficulties:
  - States have different rules and inconsistent application.
  - Employees frequently traveling to various non-resident states could have numerous filing requirements.
  - State withholding requirements would require employers to have a handle on where there employees worked.

# Mobile Workforce Bill (pending)

Mobile Workforce Bill (H.R. 1129 with Congressional subcommittee-not passed but in discussions)

- Simplifies State Income Tax Compliance
- States can technically tax individuals for wages earned acting as an employee within the state (withholding would be required)
- Would tax nonresident employees only if employment duties occur more than 30 days in a calendar year
- Retroactive withholding in the state once an employee passes the 30 day limit
- Day in a non-resident state counts if employee performs material employment duties in that state (tie with resident state goes to non-resident state)
- Each day is allocated to only one state (avoids double taxation)
- In transit time does not count for determining a day in a nonresident state
- Employers can rely on employees reporting of nonresident state time unless they have full knowledge and tracking of employee time (employers can track if desired but not required)

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## IRS Audit Considerations

- Employees vs. Contractors
- Penalties
- COD
- Theft loss
- FBAR
- NOL
- Flow through loss-limitation
- Preparer penalties
- Loan vs. capital contribution



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## Quick Access to IRS Forms and Publications



For quick access to federal forms and publications without having to click through the IRS website then go to:

[www.irs.gov/pub/irs-pdf/](http://www.irs.gov/pub/irs-pdf/)

On that site you will see a listing of (f)orms, (i)nstructions, (p)ublications and (n)otices available. When entering the above url you can immediately also add the letter in ( ) brackets above and then the form or publication number, if a schedule Then add the letter S then the schedule letter and then end in .pdf (that is a period and then pdf).

For instance if you enter [www.irs.gov/pub/irs-pdf/f1040sse.pdf](http://www.irs.gov/pub/irs-pdf/f1040sse.pdf) it will pull up the Form 1040 Schedule SE but if you were to enter an i where the f is before 1040 then you will get the instructions to Form 1040 Schedule SE.

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## Conference resources



- Small Business Tax Institute Resources
  - [http://www.cob.sjsu.edu/acct&fin/tax-institute/Small\\_Bus\\_Tax\\_Institute\\_Resources.html](http://www.cob.sjsu.edu/acct&fin/tax-institute/Small_Bus_Tax_Institute_Resources.html)
- Links in conference materials (use them via the online conference materials)
  - Look for “history” button
    - <http://www.tax-institute.com>

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**26 USC § 6713**

**Disclosure or Use of Information  
by Preparers of Returns**

**(Civil Penalty)**

**(d) Day on which failure occurs**

For purposes of this section, any failure to meet the requirement of section 6113 with respect to a solicitation—

- (1) by television or radio, shall be treated as occurring when the solicitation was telecast or broadcast,
- (2) by mail, shall be treated as occurring when the solicitation was mailed,
- (3) not by mail but in written or printed form, shall be treated as occurring when the solicitation was distributed, or
- (4) by telephone, shall be treated as occurring when the solicitation was made.

(Added Pub. L. 100-203, title X, § 10701(b), Dec. 22, 1987, 101 Stat. 1330-458.)

**EFFECTIVE DATE**

Section applicable to solicitations after Jan. 31, 1988, see section 10701(d) of Pub. L. 100-203, set out as a note under section 6113 of this title.

**§ 6711. Failure by tax-exempt organization to disclose that certain information or service available from Federal Government**

**(a) Imposition of penalty**

If—

- (1) a tax-exempt organization offers to sell (or solicits money for) specific information or a routine service for any individual which could be readily obtained by such individual free of charge (or for a nominal charge) from an agency of the Federal Government,
- (2) the tax-exempt organization, when making such offer or solicitation, fails to make an express statement (in a conspicuous and easily recognizable format) that the information or service can be so obtained, and
- (3) such failure is due to intentional disregard of the requirements of this subsection,

such organization shall pay a penalty determined under subsection (b) for each day on which such a failure occurred.

**(b) Amount of penalty**

The penalty under subsection (a) for any day on which a failure referred to in such subsection occurred shall be the greater of—

- (1) \$1,000, or
- (2) 50 percent of the aggregate cost of the offers and solicitations referred to in subsection (a)(1) which occurred on such day and with respect to which there was such a failure.

**(c) Definitions**

For purposes of this section—

**(1) Tax-exempt organization**

The term "tax-exempt organization" means any organization which—

- (A) is described in subsection (c) or (d) of section 501 and exempt from taxation under section 501(a), or
- (B) is a political organization (as defined in section 527(e)).

**(2) Day on which failure occurs**

The day on which any failure referred to in subsection (a) occurs shall be determined under rules similar to the rules of section 6710(d).

(Added Pub. L. 100-203, title X, § 10705(a), Dec. 22, 1987, 101 Stat. 1330-463.)

**EFFECTIVE DATE**

Section 10705(c) of Pub. L. 100-203 provided that: "The amendments made by this section [enacting this section] shall apply to offers and solicitations after January 31, 1988."

**§ 6712. Failure to disclose treaty-based return positions**

**(a) General rule**

If a taxpayer fails to meet the requirements of section 6114, there is hereby imposed a penalty equal to \$1,000 (\$10,000 in the case of a C corporation) on each such failure.

**(b) Authority to waive**

The Secretary may waive all or any part of the penalty provided by this section on a showing by the taxpayer that there was reasonable cause for the failure and that the taxpayer acted in good faith.

**(c) Penalty in addition to other penalties**

The penalty imposed by this section shall be in addition to any other penalty imposed by law.

(Added Pub. L. 100-647, title I, § 1012(aa)(5)(B), Nov. 10, 1988, 102 Stat. 3532.)

**CODIFICATION**

Another section 6712 was renumbered section 6713 of this title.

**EFFECTIVE DATE**

Section applicable to taxable periods the due date for filing returns for which (without extension) occurs after Dec. 31, 1988, see section 1012(aa)(5)(D) of Pub. L. 100-647, set out as a note under section 6114 of this title.

**§ 6713. Disclosure or use of information by preparers of returns**

**(a) Imposition of penalty**

If any person who is engaged in the business of preparing, or providing services in connection with the preparation of, returns of tax imposed by chapter 1, or any person who for compensation prepares any such return for any other person, and who—

- (1) discloses any information furnished to him for, or in connection with, the preparation of any such return, or
- (2) uses any such information for any purpose other than to prepare, or assist in preparing, any such return,

shall pay a penalty of \$250 for each such disclosure or use, but the total amount imposed under this subsection on such a person for any calendar year shall not exceed \$10,000.

**(b) Exceptions**

The rules of section 7216(b) shall apply for purposes of this section.

**(c) Deficiency procedures not to apply**

Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by this section.

(Added Pub. L. 100-647, title VI, § 6242(a), Nov. 10, 1988, 102 Stat. 3749, § 6712; renumbered § 6713, Pub.



L. 101-239, title VII, §7816(v)(1), Dec. 19, 1989, 103 Stat. 2423.)

EFFECTIVE DATE

Section 6242(d) of Pub. L. 100-647 provided that: "The amendments made by this section [enacting this section and amending section 7216 of this title] shall apply to disclosures or uses after December 31, 1988."

**§ 6714. Failure to meet disclosure requirements applicable to quid pro quo contributions**

**(a) Imposition of penalty**

If an organization fails to meet the disclosure requirement of section 6115 with respect to a quid pro quo contribution, such organization shall pay a penalty of \$10 for each contribution in respect of which the organization fails to make the required disclosure, except that the total penalty imposed by this subsection with respect to a particular fundraising event or mailing shall not exceed \$5,000.

**(b) Reasonable cause exception**

No penalty shall be imposed under this section with respect to any failure if it is shown that such failure is due to reasonable cause.

(Added Pub. L. 103-66, title XIII, §13173(b), Aug. 10, 1993, 107 Stat. 456.)

CODIFICATION

Another section 6714 was renumbered section 6715 of this title.

EFFECTIVE DATE

Section applicable to quid pro quo contributions made on or after Jan. 1, 1994, see section 13173(d) of Pub. L. 103-66, set out as a note under section 6115 of this title.

**§ 6715. Dyed fuel sold for use or used in taxable use, etc.**

**(a) Imposition of penalty**

If—

(1) any dyed fuel is sold or held for sale by any person for any use which such person knows or has reason to know is not a nontaxable use of such fuel,

(2) any dyed fuel is held for use or used by any person for a use other than a nontaxable use and such person knew, or had reason to know, that such fuel was so dyed,

(3) any person willfully alters, chemically or otherwise, or attempts to so alter, the strength or composition of any dye or marking done pursuant to section 4082 in any dyed fuel, or

(4) any person who has knowledge that a dyed fuel which has been altered as described in paragraph (3) sells or holds for sale such fuel for any use which the person knows or has reason to know is not a nontaxable use of such fuel,

then such person shall pay a penalty in addition to the tax (if any).

**(b) Amount of penalty**

**(1) In general**

Except as provided in paragraph (2), the amount of the penalty under subsection (a) on each act shall be the greater of—

(A) \$1,000, or

(B) \$10 for each gallon of the dyed fuel involved.

**(2) Multiple violations**

In determining the penalty under subsection (a) on any person, paragraph (1) shall be applied by increasing the amount in paragraph (1)(A) by the product of such amount and the number of prior penalties (if any) imposed by this section on such person (or a related person or any predecessor of such person or related person).

**(c) Definitions**

For purposes of this section—

**(1) Dyed fuel**

The term "dyed fuel" means any dyed diesel fuel or kerosene, whether or not the fuel was dyed pursuant to section 4082.

**(2) Nontaxable use**

The term "nontaxable use" has the meaning given such term by section 4082(b).

**(d) Joint and several liability of certain officers and employees**

If a penalty is imposed under this section on any business entity, each officer, employee, or agent of such entity who willfully participated in any act giving rise to such penalty shall be jointly and severally liable with such entity for such penalty.

**(e) No administrative appeal for third and subsequent violations**

In the case of any person who is found to be subject to the penalty under this section after a chemical analysis of such fuel and who has been penalized under this section at least twice after the date of the enactment of this subsection, no administrative appeal or review shall be allowed with respect to such finding except in the case of a claim regarding—

(1) fraud or mistake in the chemical analysis, or

(2) mathematical calculation of the amount of the penalty.

(Added Pub. L. 103-66, title XIII, §13242(b)(1), Aug. 10, 1993, 107 Stat. 520, §6714; renumbered §6715, Pub. L. 104-188, title I, §1703(n)(9)(A), Aug. 20, 1996, 110 Stat. 1877; amended Pub. L. 105-34, title X, §1032(e)(11), Aug. 5, 1997, 111 Stat. 935; Pub. L. 108-357, title VIII, §§855(a), 856(a), (b), Oct. 22, 2004, 118 Stat. 1616, 1617.)

REFERENCES IN TEXT

The date of the enactment of this subsection, referred to in subsec. (e), is the date of enactment of Pub. L. 108-357, which was approved Oct. 22, 2004.

AMENDMENTS

2004—Subsec. (a)(2). Pub. L. 108-357, §856(a), which directed amendment of par. (2) by striking "or", was executed by striking "or" at the end.

Subsec. (a)(3). Pub. L. 108-357, §856(b), substituted "alters, chemically or otherwise, or attempts to so alter," for "alters, or attempts to alter,".

Pub. L. 108-357, §856(a), inserted "or" at end.

Subsec. (a)(4). Pub. L. 108-357, §856(a), added par. (4).

Subsec. (e). Pub. L. 108-357, §855(a), added subsec. (e).

1997—Subsec. (c)(1). Pub. L. 105-34 inserted "or kerosene" after "diesel fuel".

**26 USC § 7216**

**Disclosure or Use of Information  
by Preparers of Returns  
(Criminal Penalty)**

**Internal Revenue Service, Treasury**

**§ 301.7216-1**

- (b) Disclosures to the IRS.
- (c) Disclosures or uses for preparation of a taxpayer's return.
- (d) Disclosures to other tax return preparers.
- (e) Disclosure or use of information in the case of related taxpayers.
- (f) Disclosure pursuant to an order of a court, or an administrative order, demand, request, summons or subpoena which is issued in the performance of its duties by a Federal or State agency, the United States Congress, a professional association ethics committee or board, or the Public Company Accounting Oversight Board.
- (g) Disclosure for use in securing legal advice, Treasury investigations or court proceedings.
- (h) Certain disclosures by attorneys and accountants.
  - (i) Corporate fiduciaries.
  - (j) Disclosure to taxpayer's fiduciary.
- (k) Disclosure or use of information in preparation or audit of State or local tax returns or assisting a taxpayer with foreign country tax obligations.
- (l) Payment for tax preparation services.
- (m) Retention of records.
- (n) [Reserved] For further guidance, see entry for § 301.7216-2T(n).
- (o) [Reserved] For further guidance, see entry for § 301.7216-2T(o).
- (p) [Reserved] For further guidance, see entry for § 301.7216-2T(p).
- (q) Disclosure to report the commission of a crime.
- (r) Disclosure of tax return information due to a tax return preparer's incapacity or death.
- (s) Effective date.

*§ 301.7216-3 Disclosure or use permitted only with the taxpayer's consent.*

- (a) In general.
- (b) Timing requirements and limitations.
- (c) Special rules.
- (d) Effective date.

[T.D. 9375, 73 FR 1067, Jan. 7, 2008, as amended by T.D. 9478, 75 FR 52, Jan. 4, 2010]

**§ 301.7216-0T Table of contents.**

This section lists captions contained in § 301.7216-2T.

*§ 301.7216-2T Permissible disclosures or uses without consent of the taxpayer (temporary).*

- (a) through (m) [Reserved] For further guidance, see entries for § 301.7216-2(a) through (m).
- (n) Lists for solicitation of tax return business.
- (o) Producing statistical information in connection with tax return preparation business.
- (p) Disclosure or use of information for quality, peer, or conflict reviews.

(q) through (r) [Reserved] For further guidance, see entries for § 301.7216-2(q) through (r).

- (s) Effective/applicability date.
- (t) Expiration date.

[T.D. 9478, 75 FR 52, Jan. 4, 2010]

**§ 301.7216-1 Penalty for disclosure or use of tax return information.**

(a) *In general.* Section 7216(a) prescribes a criminal penalty for tax return preparers who knowingly or recklessly disclose or use tax return information for a purpose other than preparing a tax return. A violation of section 7216 is a misdemeanor, with a maximum penalty of up to one year imprisonment or a fine of not more than \$1,000, or both, together with the costs of prosecution. Section 7216(b) establishes exceptions to the general rule in section 7216(a) prohibiting disclosure and use. Section 7216(b) also authorizes the Secretary to promulgate regulations prescribing additional permitted disclosures and uses. Section 6713(a) prescribes a related civil penalty for disclosures and uses that constitute a violation of section 7216. The penalty for violating section 6713 is \$250 for each prohibited disclosure or use, not to exceed a total of \$10,000 for a calendar year. Section 6713(b) provides that the exceptions in section 7216(b) also apply to section 6713. Under section 7216(b), the provisions of section 7216(a) will not apply to any disclosure or use permitted under regulations prescribed by the Secretary.

(b) *Definitions.* For purposes of section 7216 and §§ 301.7216-1 through 301.7216-3:

(1) *Tax return.* The term *tax return* means any return (or amended return) of income tax imposed by chapter 1 of the Internal Revenue Code.

(2) *Tax return preparer—(i) In general.* The term *tax return preparer* means:

(A) Any person who is engaged in the business of preparing or assisting in preparing tax returns;

(B) Any person who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns, including a person who develops software that is used to prepare or file a tax return and any Authorized IRS e-file Provider;



(C) Any person who is otherwise compensated for preparing, or assisting in preparing, a tax return for any other person; or

(D) Any individual who, as part of their duties of employment with any person described in paragraph (b)(2)(1)(A), (B), or (C) of this section performs services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, a tax return.

(ii) *Business of preparing returns.* A person is engaged in the business of preparing tax returns as described in paragraph (b)(2)(1)(A) of this section if, in the course of the person's business, the person holds himself out to tax return preparers or taxpayers as a person who prepares tax returns or assists in preparing tax returns, whether or not tax return preparation is the person's sole business activity and whether or not the person charges a fee for tax return preparation services.

(iii) *Providing auxiliary services.* A person is engaged in the business of providing auxiliary services in connection with the preparation of tax returns as described in paragraph (b)(2)(1)(B) of this section if, in the course of the person's business, the person holds himself out to tax return preparers or to taxpayers as a person who performs auxiliary services, whether or not providing the auxiliary services is the person's sole business activity and whether or not the person charges a fee for the auxiliary services. Likewise, a person is engaged in the business of providing auxiliary services if, in the course of the person's business, the person receives a taxpayer's tax return information from another tax return preparer pursuant to the provisions of § 301.7216-2(d)(2).

(iv) *Otherwise compensated.* A tax return preparer described in paragraph (b)(2)(1)(C) of this section includes any person who—

(A) Is compensated for preparing a tax return for another person, but not in the course of a business; or

(B) Is compensated for helping, on a casual basis, a relative, friend, or other acquaintance to prepare their tax return.

(v) *Exclusions.* A person is not a tax return preparer merely because he

leases office space to a tax return preparer, furnishes credit to a taxpayer whose tax return is prepared by a tax return preparer, furnishes information to a tax return preparer at the taxpayer's request, furnishes access (free or otherwise) to a separate person's tax return preparation Web site through a hyperlink on his own Web site, or otherwise performs some service that only incidentally relates to the preparation of tax returns.

(vi) *Examples.* The application of § 301.7216-1(b)(2) may be illustrated by the following examples:

*Example 1.* Bank B is a tax return preparer within the meaning of paragraph (b)(2)(1)(A) of this section, and an Authorized IRS e-file Provider. B employs one individual, Q, to solicit the necessary tax return information for the preparation of a tax return; another individual, R, to prepare the return on the basis of the information that is furnished; a secretary, S, who types the information on the returns into a computer; and an administrative assistant, T, who uses a computer to file electronic versions of the tax returns. Under these circumstances, only R is a tax return preparer for purposes of section 7701(a)(36), but all four employees are tax return preparers for purposes of section 7216, as provided in paragraph (b) of this section.

*Example 2.* Tax return preparer P contracts with department store D to rent space in D's store. D advertises that taxpayers who use P's services may charge the cost of having their tax return prepared to their charge account with D. Under these circumstances, D is not a tax return preparer because it provides space, credit, and services only incidentally related to the preparation of tax returns.

(3) *Tax return information—(i) In general.* The term *tax return information* means any information, including, but not limited to, a taxpayer's name, address, or identifying number, which is furnished in any form or manner for, or in connection with, the preparation of a tax return of the taxpayer. This information includes information that the taxpayer furnishes to a tax return preparer and information furnished to the tax return preparer by a third party. Tax return information also includes information the tax return preparer derives or generates from tax return information in connection with the preparation of a taxpayer's return.

(A) Tax return information can be provided directly by the taxpayer or by

another person. Likewise, tax return information includes information received by the tax return preparer from the IRS in connection with the processing of such return, including an acknowledgment of acceptance or notice of rejection of an electronically filed return.

(B) Tax return information includes statistical compilations of tax return information, even in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. See § 301.7216-2(o) for limited use of tax return information to make statistical compilations without taxpayer consent and to use the statistical compilations for limited purposes.

(C) Tax return information does not include information identical to any tax return information that has been furnished to a tax return preparer if the identical information was obtained otherwise than in connection with the preparation of a tax return.

(D) Information is considered "in connection with tax return preparation," and therefore tax return information, if the taxpayer would not have furnished the information to the tax return preparer but for the intention to engage, or the engagement of, the tax return preparer to prepare the tax return.

(i) *Examples.* The application of this paragraph (b)(3) may be illustrated by the following examples:

*Example 1.* Taxpayer A purchases computer software designed to assist with the preparation and filing of her income tax return. When A loads the software onto her computer, it prompts her to register her purchase of the software. In this situation, the software provider is a tax return preparer under paragraph (b)(2)(1)(B) of this section and the information that A provides to register her purchase is tax return information because she is providing it in connection with the preparation of a tax return.

*Example 2.* Corporation A is a brokerage firm that maintains a Web site through which its clients may access their accounts, trade stocks, and generally conduct a variety of financial activities. Through its Web site, A offers its clients free access to its own tax preparation software. Taxpayer B is a client of A and has furnished A his name, address, and other information when registering for use of A's Web site to use A's brokerage services. In addition, A has a

record of B's brokerage account activity, including sales of stock, dividends paid, and IRA contributions made. B uses A's tax preparation software to prepare his tax return. The software populates some fields on B's return on the basis of information A already maintains in its databases. A is a tax return preparer within the meaning of paragraph (b)(2)(1)(B) of this section because it has prepared and provided software for use in preparing tax returns. The information in A's databases that the software accesses to populate B's return, *i.e.*, the registration information and brokerage account activity, is not tax return information because A did not receive that information in connection with the preparation of a tax return. Once A uses the information to populate the return, however, the information associated with the return becomes tax return information. If A retains the information in a form in which A can identify that the information was used in connection with the preparation of a return, the information in that form is tax return information. If, however, A retains the information in a database in which A cannot identify whether the information was used in connection with the preparation of a return, then that information is not tax return information.

(4) *Use—(i) In general.* Use of tax return information includes any circumstance in which a tax return preparer refers to, or relies upon, tax return information as the basis to take or permit an action.

(ii) *Example.* The application of this paragraph (b)(4) may be illustrated by the following example:

*Example.* Preparer G is a tax return preparer as defined by paragraph (b)(2)(1)(A) of this section. If G determines, upon preparing a return, that the taxpayer is eligible to make a contribution to an individual retirement account (IRA), G will ask whether the taxpayer desires to make a contribution to an IRA. G does not ask about IRAs in cases in which the taxpayer is not eligible to make a contribution. G is using tax return information when it asks whether a taxpayer is interested in making a contribution to an IRA because G is basing the inquiry upon knowledge gained from information that the taxpayer furnished in connection with the preparation of the taxpayer's return.

(5) *Disclosure.* The term *disclosure* means the act of making tax return information known to any person in any manner whatever. To the extent that a taxpayer's use of a hyperlink results in the transmission of tax return information, this transmission of tax return information is a disclosure by the tax

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return preparer subject to penalty under section 7216 if not authorized by regulation.

(6) *Hyperlink.* For purposes of section 7216, a hyperlink is a device used to transfer an individual using tax preparation software from a tax return preparer's Web page to a Web page operated by another person without the individual having to separately enter the Web address of the destination page.

(7) *Request for consent.* A request for consent includes any effort by a tax return preparer to obtain the taxpayer's consent to use or disclose the taxpayer's tax return information. The act of supplying a taxpayer with a paper or electronic form that meets the requirements of a revenue procedure published pursuant to § 301.7216-3(a) is a request for a consent. When a tax return preparer requests a taxpayer's consent, any associated efforts of the tax return preparer, including, but not limited to, verbal or written explanations of the form, are part of the request for consent.

(c) *Gramm-Leach-Bliley Act.* Any applicable requirements of the Gramm-Leach-Bliley Act, Public Law 106-102 (113 Stat. 1338), do not supersede, alter, or affect the requirements of section 7216 and §§ 301.7216-1 through 301.7216-3. Similarly, the requirements of section 7216 and §§ 301.7216-1 through 301.7216-3 do not override any requirements or restrictions of the Gramm-Leach-Bliley Act, which are in addition to the requirements or restrictions of section 7216 and §§ 301.7216-1 through 301.7216-3.

(d) *Effective/applicability date.* This section applies to disclosures or uses of tax return information occurring on or after January 1, 2009.

[T.D. 9375, 73 FR 1067, Jan. 7, 2008]

### § 301.7216-2 Permissible disclosures or uses without consent of the taxpayer.

(a) *Disclosure pursuant to other provisions of the Internal Revenue Code.* The provisions of section 7216(a) and § 301.7216-1 shall not apply to any disclosure of tax return information if the disclosure is made pursuant to any other provision of the Internal Revenue Code or the regulations thereunder.

(b) *Disclosures to the IRS.* The provisions of section 7216(a) and § 301.7216-1

shall not apply to any disclosure of tax return information to an officer or employee of the IRS.

(c) *Disclosures or uses for preparation of a taxpayer's return—(1) Updating Taxpayers' Tax Return Preparation Software.* If a tax return preparer provides software to a taxpayer that is used in connection with the preparation or filing of a tax return, the tax return preparer may use the taxpayer's tax return information to update the taxpayer's software for the purpose of addressing changes in IRS forms, e-file specifications and administrative, regulatory and legislative guidance or to test and ensure the software's technical capabilities without the taxpayer's consent under § 301.7216-3.

(2) *Tax return preparers located within the same firm in the United States.* If a taxpayer furnishes tax return information to a tax return preparer located within the United States, including any territory or possession of the United States, an officer, employee, or member of a tax return preparer may use the tax return information, or disclose the tax return information to another officer, employee, or member of the same tax return preparer, for the purpose of performing services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the taxpayer's tax return. If an officer, employee, or member to whom the tax return information is to be disclosed is located outside of the United States or any territory or possession of the United States, the taxpayer's consent under § 301.7216-3 prior to any disclosure is required.

(3) *Furnishing tax return information to tax return preparers located outside the United States.* If a taxpayer initially furnishes tax return information to a tax return preparer located outside of the United States or any territory or possession of the United States, an officer, employee, or member of a tax return preparer may use tax return information, or disclose any tax return information to another officer, employee, or member of the same tax return preparer, for the purpose of performing services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation



**26 USC § 7525**

**Confidentiality privileges  
relating to taxpayer communications**

under part A of title IV of the Social Security Act” for “aid to families with dependent children”.

**EFFECTIVE DATE OF 2008 AMENDMENT**

Amendment of this section and repeal of Pub. L. 110-234 by Pub. L. 110-246 effective May 22, 2008, the date of enactment of Pub. L. 110-234, except as otherwise provided, see section 4 of Pub. L. 110-246, set out as an Effective Date note under section 8701 of Title 7, Agriculture.

Amendment by section 4002(b)(1)(E), (2)(O) of Pub. L. 110-246 effective Oct. 1, 2008, see section 4407 of Pub. L. 110-246, set out as a note under section 1161 of Title 2, The Congress.

**EFFECTIVE DATE OF 1996 AMENDMENT**

Amendment by Pub. L. 104-193 effective July 1, 1997, with transition rules relating to State options to accelerate such date, rules relating to claims, actions, and proceedings commenced before such date, rules relating to closing out of accounts for terminated or substantially modified programs and continuance in office of Assistant Secretary for Family Support, and provisions relating to termination of entitlement under AFDC program, see section 116 of Pub. L. 104-193, as amended, set out as an Effective Date note under section 601 of Title 42, The Public Health and Welfare.

**EFFECTIVE DATE**

Section 11622(c) of Pub. L. 101-508 provided that: “The amendments made by this section [enacting this section] shall apply to instructions prepared for taxable years beginning after 1990.”

**§ 7524. Annual notice of tax delinquency**

Not less often than annually, the Secretary shall send a written notice to each taxpayer who has a tax delinquent account of the amount of the tax delinquency as of the date of the notice.

(Added Pub. L. 104-168, title XII, § 1204(a), July 30, 1996, 110 Stat. 1471.)

**EFFECTIVE DATE**

Section 1204(c) of Pub. L. 104-168 provided that: “The amendments made by this section [enacting this section] shall apply to calendar years after 1996.”

**§ 7525. Confidentiality privileges relating to taxpayer communications**

**(a) Uniform application to taxpayer communications with federally authorized practitioners**

**(1) General rule**

With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

**(2) Limitations**

Paragraph (1) may only be asserted in—

(A) any noncriminal tax matter before the Internal Revenue Service; and

(B) any noncriminal tax proceeding in Federal court brought by or against the United States.

**(3) Definitions**

For purposes of this subsection—

**(A) Federally authorized tax practitioner**

The term “federally authorized tax practitioner” means any individual who is author-

ized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code.

**(B) Tax advice**

The term “tax advice” means advice given by an individual with respect to a matter which is within the scope of the individual’s authority to practice described in subparagraph (A).

**(b) Section not to apply to communications regarding tax shelters**

The privilege under subsection (a) shall not apply to any written communication which is—

- (1) between a federally authorized tax practitioner and—
  - (A) any person,
  - (B) any director, officer, employee, agent, or representative of the person, or
  - (C) any other person holding a capital or profits interest in the person, and
- (2) in connection with the promotion of the direct or indirect participation of the person in any tax shelter (as defined in section 6662(d)(2)(C)(ii)).

(Added Pub. L. 105-206, title III, § 3411(a), July 22, 1998, 112 Stat. 750; amended Pub. L. 108-357, title VIII, § 813(a), Oct. 22, 2004, 118 Stat. 1581.)

**AMENDMENTS**

2004—Subsec. (b). Pub. L. 108-357 amended heading and text of subsec. (b) generally. Prior to amendment, text read as follows: “The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(ii)).”

**EFFECTIVE DATE OF 2004 AMENDMENT**

Pub. L. 108-357, title VIII, § 813(b), Oct. 22, 2004, 118 Stat. 1581, provided that: “The amendment made by this section [amending this section] shall apply to communications made on or after the date of the enactment of this Act [Oct. 22, 2004].”

**EFFECTIVE DATE**

Pub. L. 105-206, title III, § 3411(c), July 22, 1998, 112 Stat. 751, provided that: “The amendments made by this section [enacting this section] shall apply to communications made on or after the date of the enactment of this Act [July 22, 1998].”

**§ 7526. Low-income taxpayer clinics**

**(a) In general**

The Secretary may, subject to the availability of appropriated funds, make grants to provide matching funds for the development, expansion, or continuation of qualified low-income taxpayer clinics.

**(b) Definitions**

For purposes of this section—

**(1) Qualified low-income taxpayer clinic**

**(A) In general**

The term “qualified low-income taxpayer clinic” means a clinic that—

- (i) does not charge more than a nominal fee for its services (except for reimbursement of actual costs incurred); and

