

# Small Business

# TAX

# WORK-

# SHOP

## Workbook



Department of the Treasury  
Internal Revenue Service

Publication 1066 (Rev. 4-99)

[www.irs.ustreas.gov](http://www.irs.ustreas.gov)

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# *The IRS Mission*

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

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Introduction

Lesson 1

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**Note: Rounding off.** On many tax returns you may round off money items to whole dollars, which is a good way to limit math and transcription errors. However, you may **not** round off on employment tax returns, which include Forms 941 and 940, discussed in Lesson 3 of this publication.

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## INTRODUCTION

# Small Business Tax Workshop

## Introduction

The Small Business Tax Workshop contains general information about different types of business organizations, recordkeeping requirements, and business tax returns. If you need more information, see LESSON 1 pages 1-24–1-26 for a list of **free** Internal Revenue Service (IRS) publications. Call the IRS toll-free at **1-800-829-3676** to order.

If you have access to a personal computer, you can also download and print any of the 600 federal tax forms with instructions, approximately 100 tax publications, and other tax materials from the IRS Internet Web site at:

**<http://www.irs.ustreas.gov>**

An alternative to downloading files from the Internet is the IRS FEDERAL TAX PRODUCTS on CD-ROM. This CD contains over 2,000 tax materials, including prior year forms. Purchase the CD-ROM via Internet at <http://www.irs.ustreas.gov/cdorders> from the National Technical Information Service (NTIS) for \$13 (plus a \$5 handling fee) and enjoy a savings of 35% or call toll-free at 1-877-CDFORMS (1-877-233-6767) for \$20 (plus a \$5 handling fee). Order 50 or more copies and save \$7.00 per CD.

Another option is to receive forms, instructions and tax information from your fax machine by dialing (703) 368-9694 and following the prompts.

The “Tax Info for Business” section on the IRS Web site includes a “Small Business Corner.” This area is designed to provide important information to Small Business and is arranged by business life cycle. The “Small Business Corner” provides subsections titled: Before Starting Your Business, Operating Your Business and Employment Taxes. Check it out at: [http://www.irs.gov/prod/bus\\_info/sm\\_bus/index.html](http://www.irs.gov/prod/bus_info/sm_bus/index.html).

You will be required to pay federal employment taxes if you have employees. Lessons 2 and 3 explain your responsibilities for paying these taxes.

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## Taxpayer Rights

As a taxpayer, you have the right to be treated fairly, professionally, promptly, and courteously by Internal Revenue Service employees.

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### *IRS Mission*

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

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A discussion of your right to fairness if your return is examined or your account is in the collection process is included in Publication 1, *YOUR RIGHTS AS A TAXPAYER*.



**Internal  
Revenue  
Service**

You should find it helpful to have a general understanding of some activities of the IRS and how they relate to you as a business taxpayer. There are five areas of activity within the IRS with which you should be acquainted: Customer Services, Service Centers, Examination and Appeals, Collection, and the Problem Resolution/Taxpayer Advocate Office.

## Customer Services

Customer Services is a liaison between taxpayers and IRS service centers. Customer Services representatives can explain notices and answer other inquiries about your tax accounts. They can also help you understand and apply tax laws to help you determine your specific tax liability.

## Service Centers

When you mail your business and personal tax returns, they go to a regional service center for processing. IRS processes them with an automated data processing (ADP) system. The ADP system keeps a record of all business and individual tax return transactions. Computer-generated bills for taxes due and notices explaining changes to accounts are sent to taxpayers by the service centers, and service centers arrange for taxpayers' refund checks to be sent to them.

## Examination and Appeals

The IRS is required by law to determine and collect from each taxpayer only the correct amount of tax due. One way the IRS meets this obligation is by examining returns. A notice of examination does not necessarily mean that the IRS has found, or will find, something wrong with your return.

Tax returns are selected for examination for various reasons. Returns are computer-scored according to their probability of error. The selection may mean you did not give enough information about some item of income or deduction. You may have included nontaxable income or deducted an unallowable expense. You may have filed a claim for refund, and the return is examined to make sure the correct amount of tax is refunded.

Your tax return may be examined in your place of business, at an IRS office, or at your tax representative's office. When the examination is completed, any adjustment will be explained to you. If you agree with any proposal to increase or decrease your tax liability, you will be asked to sign an agreement form. If you do not agree with any changes that are proposed by the examiner, you have certain appeal rights, both within the IRS and in the courts.

For more information, see Publication 556, EXAMINATION OF RETURNS, APPEAL RIGHTS, AND CLAIMS FOR REFUND.

## Collection

Most taxpayers pay their taxes by the date the return is due. For those who do not pay on time, the collection process begins when a taxpayer is sent a notice (demand for payment) from the IRS. The taxpayer should either pay the amount due or contact the IRS immediately. If the taxpayer does contact the IRS, an IRS employee will help determine whether the notice is valid, and, if so, how to pay any amount owed.

If a taxpayer who receives a notice does not pay the amount due and does not contact the IRS, or if a taxpayer defaults on a payment agreement, the IRS may take enforcement actions. Examples of enforcement action include the filing of a Notice of Federal Tax Lien, the serving of a Notice of Tax Levy, and/or the seizure and sale of the taxpayer's property and rights to property.

To encourage prompt payment of withheld income and Social Security (employment and medicare taxes), Congress passed a law that provides for the trust fund recovery penalty. (These taxes are called *trust fund taxes* because you actually hold the employees' money in trust until you make a federal tax deposit in that amount.)

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For more information, see Publications 594, UNDERSTANDING THE COLLECTION PROCESS and Publication 1660, COLLECTION APPEAL RIGHTS.

### Problem Resolution Office/Taxpayer Advocate

The Problem Resolution Office is the advocate for taxpayers who have been unable to resolve problems through normal channels. If you have an *ongoing* tax problem, call the IRS toll-free hotline at 1-877-777-4778 for help. You may also write to the Taxpayer Advocate at the office that last contacted you.

If the tax problem is causing or will cause you a significant hardship, the Taxpayer Advocate will arrange for an immediate review of your problem. A significant hardship may occur if you cannot maintain your business location, utilities for your business, and the ability to meet payroll. Significant hardship could also occur if your business faces imminent bankruptcy or if the actions of IRS would cause irreparable damage to your business. While your account is reviewed, any additional enforcement action will be suspended if the Taxpayer Advocate determines that a significant hardship exists.



## Free Tax Services

Most business taxpayers should be able to meet their tax responsibilities by using the packages of tax forms and instructions they receive from the IRS. Those who need more information may turn to the IRS' many free tax publications, education programs, audiovisual materials, and other services. If additional information and assistance are needed, taxpayers can call the IRS or visit their local IRS office. By calling or visiting the IRS, taxpayers can get answers to questions about their account, general information about IRS procedures, services available, or the tax law. Publication 910, *GUIDE TO FREE TAX SERVICES*, is available by calling 1-800-829-3676 (1-800-TAX-FORM).

## Telephone service

24-hour toll-free telephone tax assistance is available in all 50 states, the District of Columbia, Puerto Rico, and the Virgin Islands by calling 1-800-829-1040.

## TELE-TAX

Tele-Tax is an IRS telephone service that provides both automated refund information and recorded tax information. The number is 1-800-829-4477.



## TTY/TDD

If you are hearing-impaired and have access to TTY/TDD equipment, you can call 1-800-829-4059 with your tax questions or to order forms and publications. See your tax form instruction booklet for the hours of operation.

## Walk-in service

Assistance is available in most IRS offices to help you in preparing your individual federal tax return. You may also obtain tax forms, publications, and help with questions about IRS notices or bills.

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**Taxpayer education programs**

The IRS has a number of programs designed to help you understand your rights and obligations under our nation's tax system. Volunteers are an important part of all these programs. To volunteer to help in one of our taxpayer education programs, or for times and locations of available services in your community, call the IRS at 1-800-829-1040 and ask for the number for your closest taxpayer education office. The taxpayer education programs are:

- Community Outreach
- Volunteer Income Tax Assistance (VITA)
- Tax Counseling for the Elderly
- Small Business Tax Education
- Post Office and Library Program
- Student Tax Clinics
- Understanding Taxes
- Practitioner Education

**Publication 17,  
YOUR FEDERAL INCOME TAX**

This publication can help you prepare your individual tax return. It takes you through the individual tax return and explains the tax laws that cover salaries and wages, interest and dividends, rental income, gains and losses, adjustments to income (such as reimbursed employee business expenses and IRA contributions), and itemized deductions.

**Publication 454,  
YOUR BUSINESS TAX KIT**

Publication 454, **YOUR BUSINESS TAX KIT**, is an assortment of IRS forms and publications to help taxpayers who operate their own businesses. Call 1-800-829-3676 to order the kit. The kit contains the following items.

**Forms:**

- SS-4, APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER
- 1040-ES, ESTIMATED TAX FOR INDIVIDUALS
- 9779, EFTPS ENROLLMENT FORM

**Publications:**

- 509, TAX CALENDARS
- 583, STARTING A BUSINESS
- 594, UNDERSTANDING THE COLLECTION PROCESS
- 910, GUIDE TO FREE TAX SERVICES
- 1544, REPORTING CASH PAYMENTS OF OVER \$10,000 (RECEIVED IN A TRADE OR BUSINESS)

## IRS e-file programs for businesses



CLICK, ZIP, FAST ROUND TRIP.

If you have employees and employment taxes to report, you can now file your Form 941, EMPLOYER'S QUARTERLY FEDERAL TAX RETURN, electronically - by telephone, on-line via personal computer, or through a third party such as a payroll service company. Visit the IRS Web site (*The Digital Daily*) at [www.irs.ustreas.gov](http://www.irs.ustreas.gov) and click on "Electronic Services" for more information. In addition, you can eliminate paper deposit coupons, trips to the bank, and postage costs, by taking advantage of the Electronic Federal Tax Payment System (EFTPS). This system, with over two million users, allows you to initiate your Federal Tax Deposits (FTDs) electronically by telephone or personal computer, or you can have your financial institution initiate payments. Although this system is mandatory only for businesses that make in excess of \$200,000 in FTDs yearly, it is highly recommended and used by other smaller depositors because of its simplicity and convenience. To learn more about EFTPS or to request an enrollment form, call EFTPS Customer Service at 1-800-555-4477 or 1-800-945-8400.

## Other sources of information



The following organizations offer services to people with small businesses:

- U.S. Government Printing Office - For a list of Federal publications that are for sale to assist small businesses, write to: Superintendent of Documents  
U.S. Government Printing Office  
P.O. Box 371954  
Pittsburgh, PA 15250-7954
- U.S. Small Business Administration (SBA)—offers many publications on topics of interest to people with small businesses. A nationwide telephone service is provided through the SBA Office of Advocacy. The Small Business Answer Desk assists callers with their small business problems. It also serves as a referral service to direct callers to the appropriate government agency, trade association, and other information services. The toll-free number, available Monday through Friday from 9:00 A.M. to 5:00 P.M. EST, is (800) 827-5722.
- Small Business Development Centers and Business Information Centers are available in all states and U.S. territories. Business workshops and counseling are available as well as research information for small businesses. Contact the SBA for local phone numbers.

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- Service Corps of Retired Executives (SCORE) and Active Corps of Executives (ACE) provide counseling for business people and conduct SBA-sponsored pre-business workshops.
  - Social Security Administration (SSA)—The SSA provides information on proper reporting of social security wages for both paper and magnetic media filers. The SSA holds joint seminars with the IRS on proper wage reporting by employers.
  - SSA and IRS issue a quarterly tax help newsletter which is designed to keep employers up to date on changes to their tax and employee wage obligations.
  - National Business, Professional, or Trade Organizations - provide information for specific businesses and trades. Some examples of these are:
    - National Federation of Independent Businesses
    - National Association of the Self-employed
    - National Association of Independent Contractors
    - U. S. Chamber of Commerce and local Chambers of Commerce
    - National Association of Enrolled Agents
    - National Society of Certified Public Accountants
  - Other Federal Agencies provide a variety of services and information for businesspersons:
    - U.S. Department of Agriculture - The Cooperative Extension Service County Agents helps rural residents manage small family businesses and farms through workshops, counseling, and other types of assistance.
    - U.S. Department of Labor - The Employment Standards Administration provides assistance regarding labor and wage relations and other labor management standards.
    - U.S. Department of Commerce - The Minority Business Development Agency supports the development of minority owned and managed businesses. Commerce also has an International Business Export Office that provides information on imports and exports.
  - State and Local Agencies - provide information about local laws and regulations affecting business people. Since

agency and organization names vary in many states, you may want to call your local or state Chamber of Commerce for help in identifying the organization you want:

- State Departments of Revenue, Taxation, or Equalization
- State Department of Commerce for Minority Business Development
- State Employment Commission or Employment Security
- State Department of Economic Development for Business Regulation
- Governor's Office of Community and Industrial Development
- Governor's Office of Minority and Small Business Development
- Small Business Development Centers and Business Resource Centers

## LESSON 1

# Business Tax Requirements

## Introduction

This section of the workshop gives general information about the types of business organizations and the advantages and disadvantages of each. In this section you will also learn about recordkeeping requirements and business tax returns.



## Types of business organizations

### Sole proprietorship

A sole proprietorship is an unincorporated business that one individual owns. It is the simplest type of business organization. The business does not exist apart from the proprietor (owner). The proprietor assumes the risks of the business to the extent of all his or her assets, whether or not the assets are used in the business.

#### **Advantages:**

1. The business is simple to organize.
2. The owner has maximum freedom to make decisions.
3. The business has a minimum of legal restrictions.
4. The owner receives all the profits.
5. The business is easy to discontinue.

**Disadvantages:**

1. The owner has unlimited liability. The individual owner is legally liable for all debts of the business. Creditors may attach all of the owner's assets, even personal assets not used in the business.
2. There usually is limited ability to raise capital. The business capital is limited to whatever the owner can secure personally. This feature may limit the expansion of a business when new capital is required. A common cause of failure for this form of business organization is its original lack of capital. Limited capital restricts the ability of a sole proprietor to operate the business effectively and survive at an initial low profit level, or to get through an economic rough spot.

For more information about sole proprietorships, see Publication 334.

**Partnership**

A partnership is a relationship between two or more persons who join together to carry on a trade or business. Each person contributes money, property, labor, or skills, and each expects to share in the profits and losses of the business. Any number of persons may join in a partnership.



For the purpose of income taxes, a partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization that carries on a business and that is not classified as a trust, estate, or corporation.

**Advantages:**

1. It is easy to organize.
2. It may have greater financial strength than a sole proprietorship.
3. It combines managerial skills and judgments of the partners.
4. It has a definite legal status.
5. Each partner has a personal interest in the business.

**Disadvantages:**

1. The liability of the partners is usually unlimited. Each partner may be held liable for all the debts of the business. Therefore, if one partner does not exercise good judgment, that partner can cause not only the loss of the partnership's assets, but also the loss of the other partners' personal assets.
2. The authority for decisions is divided.

For more information about partnerships, see Publication 541.

**Limited Liability Company (LLC)**

Many states have enacted limited liability company statutes. An LLC is a separate legal entity formed by filing articles of organization with the Secretary of State. LLCs (sometimes called Limited Liability Partnerships - LLPs) combine certain features of partnerships with certain features of corporations, most notably, limited liability. The individual members are not personally liable for the LLC's or LLP's debts or liabilities, except to the extent of their investment and capital commitment in the company. **It is important to note that an LLC/LLP is not a federal tax entity and is generally treated as a partnership by IRS.** For more information, you should contact your Secretary of State's office.

**S corporation**

An S corporation is a small business corporation that elects to have its income taxed in a manner similar to that of a partnership. In general, an S corporation does not pay tax on its income. Instead, the income and expenses of the corporation are divided among its shareholders, who then report them on their own income tax returns.

For more information about S corporations, see the Instructions for Form 1120S and Form 2553.



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## Corporation

A corporation is treated by law as a legal entity. It has a life separate from its owners and has rights and duties of its own. The owners of a corporation are the stockholders. The managers of a corporation may or may not be stockholders.

Forming a corporation involves a transfer of money or property, or both, by the prospective shareholders in exchange for capital stock in the corporation.

For the purpose of federal income tax, corporations include associations, joint stock companies, and trusts and partnerships that actually operate as associations or corporations.

### **Advantages:**

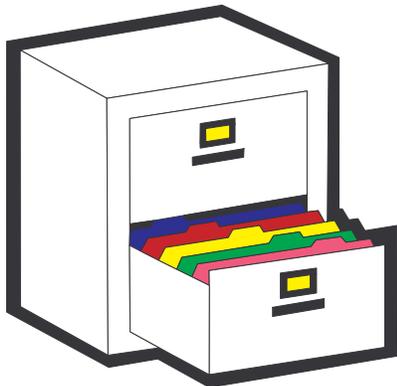
1. The life of the business is perpetual.
2. The stockholders have limited liability.
3. Transfer of ownership is easy (sale of stock).
4. It is easier for corporations to raise capital and to expand than it is for other forms of business.
5. Management is generally more efficient.
6. It is adaptable to both small and large businesses.

### **Disadvantages:**

1. It is subject to tax on its income at the corporate level and when the income is distributed as dividends, it is taxed again, this time to the shareholder.
2. It may be more difficult and expensive to organize than other forms of ownership.
3. The corporate charter restricts the types of business activities.
4. It is subject to many state and federal controls.

For more information about corporations, see Publication 542.

## Recordkeeping



You are required to keep records so that you can prepare complete and accurate tax returns. You must be able to substantiate items of income, deductions, and credits. Keeping good records will help you pay only the tax you owe. For more information about recordkeeping, see Publication 583, *STARTING A BUSINESS AND KEEPING RECORDS* and Publication 552. Always keep your business records available for examination by the IRS.

Good records can help you:

- **Identify source of receipt.** You may receive cash or property from many sources. Unless you have records showing the source of your receipts, you may not be able to prove that some are nonbusiness or nontaxable.
- **Prevent omission of deductible expenses.** You may forget expenses when you prepare your tax return, unless you record them when you incur or pay them.
- **Establish earnings for self-employment tax purposes.** Your records should show the amount of earnings reportable for self-employment tax purposes. Self-employment tax is explained later, under *BUSINESS RETURNS*.
- **Explain items on income tax return.** If IRS examines your income tax return, you may be asked to explain the items reported. You must be able to support items on your return by sales slips, invoices, receipts, bank deposit slips, canceled checks, and other documents. These items of support are necessary if you are to have adequate and complete records.

### Caution: adequate records

The recordkeeping rules require that you keep adequate documentary records or sufficient evidence corroborating your own statements, such as receipts and a log or diary, to support:

- deductions you take for travel, transportation, entertainment and business gift expenses; and
- any deduction you take for certain business property.

These records should substantiate the amount you claim, the time and place, the business purpose, and your business relationship to any other persons involved. Incomplete

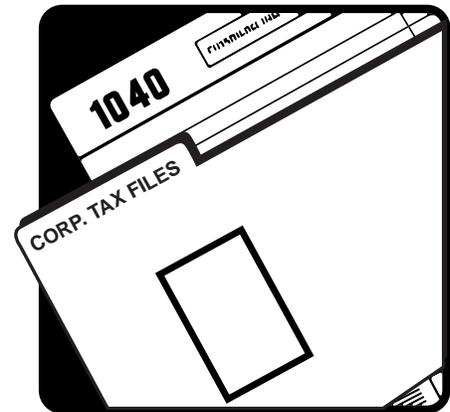
records may not be enough for the deduction to be allowed. If your records are lost due to circumstances beyond your control, such as by flood or earthquake, you may substantiate a deduction by reasonable reconstruction. See Publications 552 and 583 for more information about recordkeeping requirements.

### How long to keep records

You must keep your records as long as their contents may be material in the administration of any Internal Revenue Service law.

### Supporting records

To support items of income or deduction on your tax return, you must keep records until the statute of limitations for that return expires. Ordinarily, the statute of limitations for an income tax return expires 3 years after the return is due to be filed or is filed, or 2 years from the date the tax is paid, whichever is later.



In many cases you must keep records indefinitely. For example, if you change your method of accounting, records supporting the necessary adjustments may remain material for an indefinite time.

You must keep records relating to the basis of property for as long as they are material in determining the basis of the original or replacement property.

### Employment tax records

You must keep all employment tax records for at least 4 years after the date on which a tax return becomes due or the tax is paid, whichever is later. For more information, refer to Publication 15, EMPLOYER'S TAX GUIDE (Circular E).

### Tax returns

You should keep copies of your filed tax returns. They will help you in preparing your future tax returns, and in making computations if you later file an amended return. They may also be helpful to the executor or administrator of your estate.

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## Bookkeeping systems

Many people who run their own one-person business never bother to set up a *business* bookkeeping system separate from their personal one. Their checking account serves as both a personal and a business account. IRS recommends that you open a separate business bank account to maintain accounting efficiency.

You may use either a **single-entry** or **double-entry** system of bookkeeping. The single-entry system is the simplest to keep. The double-entry system has built-in checks and balances that give more accuracy and control.

With the single-entry system, you record a daily and a monthly summary of receipts, and a monthly summary of paid expenses. This is not a complete accounting system, but it shows income and expenses well enough for tax purposes. This system centers on the business' profit and loss statement and not on its balance sheet. An example of a single-entry system is shown in Publication 583.

The double-entry system is self-balancing. Since all business transactions consist of an exchange of one thing for another, double-entry bookkeeping is used to show this two-fold effect. You record every transaction in a journal as a debit entry in one account, and as a credit entry in another account. After you post the journal entries to the ledger accounts, the total debits must equal the total credits. If the accounts do not balance, you have made an error.

## Accounting methods

On your return you must use the same accounting method you use to keep your records. Your accounting method is a set of rules that you use to decide when and how you report your income and expenses.

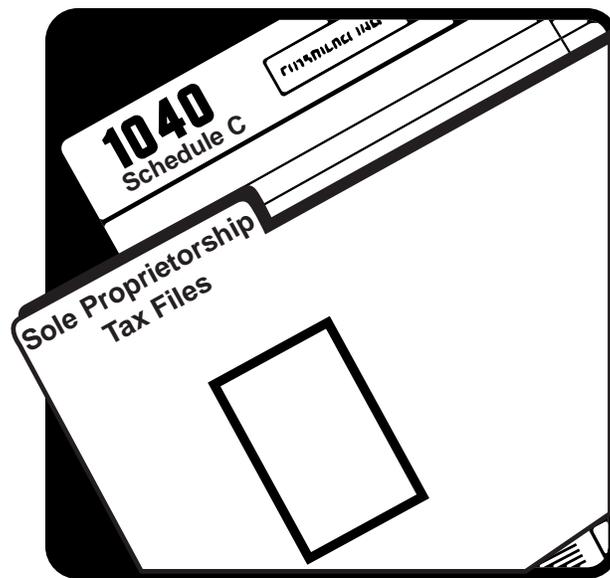
The two most commonly used accounting methods are the **cash method** and the **accrual method**. Under the cash method, you report all income in the year you receive it. You usually deduct expenses only in the tax year in which you pay them. Under the accrual method, you report income in the year you earn it, regardless of when you receive the payment. You deduct expenses in the tax year you incur them, regardless of when you pay them. If your business has an inventory, you generally must use the accrual method for purchases and sales.

## Computerized system

There are computer software packages that you can use for recordkeeping. They can be purchased in many retail stores. These packages are very useful and relatively easy to use; they require very little knowledge of bookkeeping and accounting.

**Note:** *If you use a computerized system, you must be able to produce sufficient legible records from the system to provide the information needed to determine your correct tax liability.*

## Business returns



## Income and income tax

### Sole proprietor files Schedule C

A sole proprietor files Schedule C (Form 1040), PROFIT OR LOSS FROM BUSINESS. The proprietor files it with his or her Form 1040 to report the business' profit or loss. A Schedule C example is shown later in this lesson and in Publication 334.

### Partnership files Form 1065

A partnership files Form 1065, U.S. PARTNERSHIP RETURN OF INCOME, which is an information return only. The partnership gives each partner a Schedule K-1 (Form 1065), PARTNER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC., and the partner uses it to complete Schedule E (Form 1040), SUPPLEMENTAL INCOME AND LOSS, and any other forms and schedules the partner must file with his or her individual return. A filled-in form 1065 is shown in Publication 541. (See Exhibits 1.1 and 1.2 for examples of Schedules E and K-1.)

EXHIBIT 1.1 - SCHEDULE E, PAGE 1 AND 2

<p><b>SCHEDULE E</b> <b>(Form 1040)</b></p> <p>Department of the Treasury Internal Revenue Service (O)</p>	<p><b>Supplemental Income and Loss</b> (From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)</p> <p>▶ Attach to Form 1040 or Form 1041. ▶ See instructions for Schedule E (Form 1040).</p>	<p>OMB No. 1545-0074</p> <p style="font-size: 2em; font-weight: bold;">1998</p> <p>Attachment Sequence No. <b>13</b></p>
Name(s) shown on return		Your social security number

**Part I** **Income or Loss From Rental Real Estate and Royalties** Note: Report income and expenses from your business of renting personal property on **Schedule C** or **C-EZ** (see page E-1). Report farm rental income or loss from **Form 4835** on page 2, line 39.

Schedule E (Form 1040) 1998	Attachment Sequence No. <b>13</b>	Page <b>2</b>			
Name(s) shown on return. Do not enter name and social security number if shown on other side.		Your social security number			
<p><b>Note:</b> If you report amounts from farming or fishing on Schedule E, you must enter your gross income from those activities on line 41 below. Real estate professionals must complete line 42 below.</p>					
<p><b>Part II</b> <b>Income or Loss From Partnerships and S Corporations</b> Note: If you report a loss from an at-risk activity, you <b>MUST</b> check either column (e) or (f) on line 27 to describe your investment in the activity. See page E-5. If you check column (f), you must attach <b>Form 6198</b>.</p>					
<b>27</b>	(a) Name	(b) Enter <b>P</b> for partnership; <b>S</b> for S corporation	(c) Check if foreign partnership	(d) Employer identification number	Investment At Risk? (e) All is at risk (f) Some is not at risk
A					
B					
C					
D					
E					
<b>Passive Income and Loss</b>			<b>Nonpassive Income and Loss</b>		
	(g) Passive loss allowed (attach <b>Form 8582</b> if required)	(h) Passive income from <b>Schedule K-1</b>	(i) Nonpassive loss from <b>Schedule K-1</b>	(j) Section 179 expense deduction from <b>Form 4562</b>	(k) Nonpassive income from <b>Schedule K-1</b>
A					
B					
C					
D					
E					
<b>28a</b>	Totals				
<b>b</b>	Totals				
<b>29</b>	Add columns (h) and (k) of line 28a . . . . .				<b>29</b>
<b>30</b>	Add columns (g), (i), and (j) of line 28b . . . . .				<b>30</b> ( )
<b>31</b>	Total partnership and S corporation income or (loss). Combine lines 29 and 30. Enter the result here and include in the total on line 40 below . . . . .				<b>31</b>
<b>Part III</b> <b>Income or Loss From Estates and Trusts</b>					

**38** Combine columns (g) and (e) only. Enter the result here and include in the total on line 39 below

<b>Part V</b> <b>Summary</b>				
<b>39</b>	Net farm rental income or (loss) from <b>Form 4835</b> . Also, complete line 41 below . . . . .			<b>39</b>
<b>40</b>	TOTAL income or (loss). Combine lines 26, 31, 36, 38, and 39. Enter the result here and on Form 1040, line 17 ▶			<b>40</b>
<b>41</b>	<b>Reconciliation of Farming and Fishing Income.</b> Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), line 15b; Schedule K-1 (Form 1120S), line 23; and Schedule K-1 (Form 1041), line 14 (see page E-6) . . . . .	<b>41</b>		
<b>42</b>	<b>Reconciliation for Real Estate Professionals.</b> If you were a real estate professional (see page E-4), enter the net income or (loss) you reported anywhere on Form 1040 from all rental real estate activities in which you materially participated under the passive activity loss rules. . . . .	<b>42</b>		

EXHIBIT 1.2 - SCHEDULE K-1 (FORM 1065), PAGE 1

<p><b>SCHEDULE K-1</b> <b>(Form 1065)</b> Department of the Treasury Internal Revenue Service</p>	<p><b>Partner's Share of Income, Credits, Deductions, etc.</b> ▶ See separate instructions. For calendar year 1998 or tax year beginning _____, 1998, and ending _____, 19</p>	<p>OMB No. 1545-0099 <b>1998</b></p>																																																																					
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<p><b>A</b> This partner is a <input type="checkbox"/> general partner <input type="checkbox"/> limited partner <input type="checkbox"/> limited liability company member</p> <p><b>B</b> What type of entity is this partner? ▶ _____</p> <p><b>C</b> Is this partner a <input type="checkbox"/> domestic or a <input type="checkbox"/> foreign partner?</p> <p><b>D</b> Enter partner's percentage of: (i) Before change or termination (ii) End of year</p> <p>Profit sharing . . . . . _____ % _____ % Loss sharing . . . . . _____ % _____ % Ownership of capital . . . . . _____ % _____ %</p> <p><b>E</b> IRS Center where partnership filed return: _____</p>		<p><b>F</b> Partner's share of liabilities (see instructions): Nonrecourse . . . . . \$ _____ Qualified nonrecourse financing . . . . . \$ _____ Other . . . . . \$ _____</p> <p><b>G</b> Tax shelter registration number . . . . . ▶ _____</p> <p><b>H</b> Check here if this partnership is a publicly traded partnership as defined in section 469(k)(2) . . . . . <input type="checkbox"/></p> <p><b>I</b> Check applicable boxes: (1) <input type="checkbox"/> Final K-1 (2) <input type="checkbox"/> Amended K-1</p>																																																																					
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	<b>6</b> Net section 1231 gain (loss) (other than due to casualty or theft) . . . . .	<b>6</b> _____																																																																					
	<b>7</b> Other income (loss) (attach schedule) . . . . .	<b>7</b> _____	Enter on applicable line of your return.																																																																				
<b>Deductions</b>	<b>8</b> Charitable contributions (see instructions) (attach schedule) . . . . .	<b>8</b> _____	Sch. A, line 15 or 16																																																																				
	<b>9</b> Section 179 expense deduction . . . . .	<b>9</b> _____	} See pages 7 and 8 of Partner's Instructions for Schedule K-1 (Form 1065).																																																																				
	<b>10</b> Deductions related to portfolio income (attach schedule) . . . . .	<b>10</b> _____																																																																					
	<b>11</b> Other deductions (attach schedule) . . . . .	<b>11</b> _____																																																																					
<b>Credits</b>	<b>12a</b> Low-income housing credit:	<b>a(1)</b> (1) From section 42(j)(5) partnerships for property placed in service before 1990 . . . . .	} Form 8586, line 5																																																																				
		<b>a(2)</b> (2) Other than on line 12a(1) for property placed in service before 1990 . . . . .																																																																					
		<b>a(3)</b> (3) From section 42(j)(5) partnerships for property placed in service after 1989 . . . . .																																																																					
		<b>a(4)</b> (4) Other than on line 12a(3) for property placed in service after 1989 . . . . .																																																																					
	<b>12b</b> Qualified rehabilitation expenditures related to rental real estate activities . . . . .	<b>12b</b> _____	} See page 8 of Partner's Instructions for Schedule K-1 (Form 1065).																																																																				
	<b>12c</b> Credits (other than credits shown on lines 12a and 12b) related to rental real estate activities . . . . .	<b>12c</b> _____																																																																					
	<b>12d</b> Credits related to other rental activities . . . . .	<b>12d</b> _____																																																																					
	<b>13</b> Other credits . . . . .	<b>13</b> _____																																																																					
<p>For Paperwork Reduction Act Notice, see Instructions for Form 1065.</p>		<p>Cat. No. 11394R Schedule K-1 (Form 1065) 1998</p>																																																																					

EXHIBIT 1.2 - SCHEDULE K-1 (FORM 1065), PAGE 2

Schedule K-1 (Form 1065) 1998		Page <b>2</b>	
(a) Distributive share item		(b) Amount	(c) 1040 filers enter the amount in column (b) on:
<b>Investment Interest</b>	<b>14a</b> Interest expense on investment debts . . . . .	<b>14a</b>	Form 4952, line 1 See page 9 of Partner's Instructions for Schedule K-1 (Form 1065).
	<b>b (1)</b> Investment income included on lines 4a, 4b, 4c, and 4f . . . . .	<b>b(1)</b>	
	<b>(2)</b> Investment expenses included on line 10 . . . . .	<b>b(2)</b>	
<b>Self-employment</b>	<b>15a</b> Net earnings (loss) from self-employment . . . . .	<b>15a</b>	Sch. SE, Section A or B See page 9 of Partner's Instructions for Schedule K-1 (Form 1065).
	<b>b</b> Gross farming or fishing income . . . . .	<b>15b</b>	
	<b>c</b> Gross nonfarm income . . . . .	<b>15c</b>	
<b>Adjustments and Tax Preference Items</b>	<b>16a</b> Depreciation adjustment on property placed in service after 1986 . . . . .	<b>16a</b>	See page 9 of Partner's Instructions for Schedule K-1 (Form 1065) and Instructions for Form 6251.
	<b>b</b> Adjusted gain or loss . . . . .	<b>16b</b>	
	<b>c</b> Depletion (other than oil and gas) . . . . .	<b>16c</b>	
	<b>d (1)</b> Gross income from oil, gas, and geothermal properties . . . . .	<b>d(1)</b>	
	<b>(2)</b> Deductions allocable to oil, gas, and geothermal properties . . . . .	<b>d(2)</b>	
<b>e</b> Other adjustments and tax preference items (attach schedule)	<b>16e</b>		
<b>Foreign Taxes</b>	<b>17a</b> Type of income ▶ _____		Form 1116, check boxes
	<b>b</b> Name of foreign country or possession ▶ _____		
	<b>c</b> Total gross income from sources outside the United States (attach schedule) . . . . .	<b>17c</b>	Form 1116, Part I
	<b>d</b> Total applicable deductions and losses (attach schedule) . . . . .	<b>17d</b>	
	<b>e</b> Total foreign taxes (check one): <input type="checkbox"/> Paid <input type="checkbox"/> Accrued . . . . .	<b>17e</b>	Form 1116, Part II Form 1116, Part III See Instructions for Form 1116
	<b>f</b> Reduction in taxes available for credit (attach schedule) . . . . .	<b>17f</b>	
	<b>g</b> Other foreign tax information (attach schedule) . . . . .	<b>17g</b>	
<b>Other</b>	<b>18</b> Section 59(e)(2) expenditures: <b>a</b> Type ▶ _____		See page 9 of Partner's Instructions for Schedule K-1 (Form 1065).
	<b>b</b> Amount . . . . .	<b>18b</b>	
	<b>19</b> Tax-exempt interest income . . . . .	<b>19</b>	Form 1040, line 8b
	<b>20</b> Other tax-exempt income . . . . .	<b>20</b>	
	<b>21</b> Nondeductible expenses . . . . .	<b>21</b>	See pages 9 and 10 of Partner's Instructions for Schedule K-1 (Form 1065).
	<b>22</b> Distributions of money (cash and marketable securities) . . . . .	<b>22</b>	
	<b>23</b> Distributions of property other than money . . . . .	<b>23</b>	
<b>24</b> Recapture of low-income housing credit:	<b>a</b> From section 42(j)(5) partnerships . . . . .	<b>24a</b>	Form 8611, line 8
	<b>b</b> Other than on line 24a . . . . .	<b>24b</b>	
<b>Supplemental Information</b>	<b>25</b> Supplemental information required to be reported separately to each partner (attach additional schedules if more space is needed):		
	_____		
	_____		
	_____		
	_____		
	_____		
	_____		
	_____		
	_____		
	_____		



- 
- S corporation files Form 1120S** An S corporation files Form 1120S, U.S. INCOME TAX RETURN FOR AN S CORPORATION, and pays tax on any items that are not passed through to shareholders. The S corporation gives each shareholder a Schedule K-1 (Form 1120S), SHAREHOLDER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC. The shareholder uses the Schedule K-1 to complete Schedule E (Form 1040), and any other forms and schedules the shareholder must file with his or her individual return. Refer to the Instructions for Form 1120S for more information.
- Corporation files either Form 1120 or 1120-A** A corporation files either Form 1120, U.S. CORPORATION INCOME TAX RETURN, or the short Form 1120-A, U.S. CORPORATION SHORT-FORM INCOME TAX RETURN, and pays tax on its income. A corporation's owners are shareholders and may also be employees. If the corporation paid dividends during the year, it gives each shareholder a Form 1099-DIV, STATEMENT FOR RECIPIENTS OF DIVIDENDS AND DISTRIBUTIONS. It gives each employee a Form W-2, WAGE AND TAX STATEMENT. The shareholders and employees use these forms to complete their individual returns. Publication 542 shows a filled-in Form 1120 and a filled-in Form 1120-A.
- Self-employment tax** Self-employed people (sole proprietors) and partners in a partnership pay self-employment tax in place of the social security tax that is withheld from an employee's wages. Paying self-employment tax provides social security coverage.
- You are subject to self-employment (SE) tax if you have \$400 or more of net earnings from self-employment income. In 1999 the tax rate for self-employment tax is 15.3%. The 15.3% rate is a total of 12.4% social security (old age, survivors, and disability insurance) plus 2.9% for Medicare (hospital insurance).
- Note:** *In 1998, the maximum net earnings subject to the social security portion was \$68,400. In 1999 it is \$72,600. There is no maximum limit on the amount subject to the 2.9% Medicare portion.*
- If you receive wages in 1999 from which social security and medicare taxes are withheld, subtract those wages from the maximums to figure how much self-employment income is subject to the taxes. For example, in 1999 you receive wages

of \$50,000 from your employer and net \$35,000 in self-employment income. You would first subtract your wages, \$50,000, from the social security maximum, \$72,600. Only \$22,600 of your self-employment income is subject to the 12.4% social security portion of the self-employment tax.

If you have income subject to self-employment tax, figure the tax on Schedule SE (Form 1040), *SELF-EMPLOYMENT TAX*. If you have more than one business, use one Schedule SE and combine the profits and losses from all of your businesses. You must file Schedule SE if:

- your net earnings from self-employment are \$400 or more, or
- you had church employee income of \$108.28 or more. If you are a member of the clergy or a religious worker, you may not have to pay self-employment tax if you meet certain exemption requirements.

Schedule SE is shown later in this lesson. For more information, see Publication 533, *SELF-EMPLOYMENT TAX*.

## Estimated tax

Many sole proprietors, partners, and S corporation shareholders must pay estimated income tax during the year. To determine if you must pay it, estimate your taxable income for the year. Include your self-employment income and all other taxable income. Also estimate how much of your income will be subject to withholding.

Your estimated tax is the amount by which the total of your estimated income tax and self-employment tax exceeds the tax you expect to have withheld from your wages, if any. You do not have to pay estimated tax if you reasonably expect your estimated tax to be at least \$1,000.

Use the worksheet that comes with Form 1040-ES, *ESTIMATED TAX FOR INDIVIDUALS*, to see if you must pay estimated tax and, if so, to figure the amount. Corporations figure their estimated tax on Form 1120-W (Worksheet), *ESTIMATED TAX FOR CORPORATIONS*.



## Net profit or loss

After you report income on your return, the next steps reduce the amount on which you will pay tax. The basic way to determine profit or loss is much the same for each type of business organization.

$$\text{Income} - \text{Expenses} = \text{Net profit or loss}$$

You will use this formula with some slight changes to determine your profit or loss on your tax return. This workbook expands the formula by discussing gross receipts and cost of goods sold, both of which are used in determining gross profit.

## Gross receipts or sales

Gross receipts or sales are the income that a business receives from sales of its products or services. Gross receipts less returns and allowances equal net sales in the example illustrated in this lesson, John's Furniture Store sold \$48,000 worth of furniture and had no returns or allowances. Therefore, the store had \$48,000 in both gross receipts and net receipts.

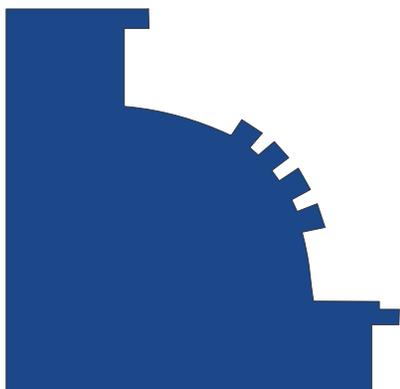
## Cost of goods sold

Cost of goods sold is the cost to a business to buy or make the product that it sold. It would be easy to figure the cost of goods sold if you sold all your merchandise during the year. However, some of your sales will probably be from inventory that you carried over from earlier years and you will probably have inventory left unsold at the end of the year.

To figure the cost of goods sold, add the cost of goods purchased or manufactured during the year (less the cost of any merchandise withdrawn for personal use) to the value of the inventory on hand at the beginning of the year, and subtract the value of your inventory at the end of the year. This can be stated:

$$\text{Beginning inventory} + \text{Purchases} - \text{Ending inventory} = \text{Cost of goods sold}$$

For example, John's Furniture Store had an inventory of \$12,000 at the beginning of the year; purchased furniture costing \$26,000 during the year; and had an ending inventory of \$9,800. The cost of goods sold was \$28,200 (\$12,000 + \$26,000 - \$9,800 = \$28,200).



## Gross profit



Gross profit equals the net receipts (the balance of gross receipts less returns and allowances) less the cost of goods sold. John's Furniture Store had gross (and net) receipts of \$48,000 and the cost of goods sold was \$28,200. The store's gross profit was \$19,800 ( $\$48,000 - \$28,200 = \$19,800$ ).

## Business expenses

Business expenses are the ordinary and necessary expenses that are incurred in the operation of a business. The cost of business property that has a life of more than 1 year, such as a truck or a building, is not considered a current business expense. That cost is usually deducted on your tax return over a number of years as depreciation (discussed later). John's Furniture Store had a total of \$11,000 in current business expenses and depreciation.

## Net profit or loss

Net profit or loss is the amount by which the gross profit and any other income for a period is more (or less, in the case of a loss) than the business expenses and depreciation for the same period. John's Furniture Store had a gross profit of \$19,800 and business expenses of \$11,000. The store's net profit was \$8,800 ( $\$19,800 - \$11,000 = \$8,800$ ).

A filled-in Schedule C and SE, the forms for a sole proprietorship, are shown as examples (Exhibits 1-3 and 1-4). The same principles apply to forms for other types of business organizations. After you determine income, you must determine expenses, which is the other item in the formula for computing profit or loss.

**Note:** *You may be able to file the shorter Schedule C-EZ if you meet certain requirements. For more information see Schedule C-EZ.*

EXHIBIT 1.3 - SCHEDULE C, Pg. 1

<p><b>SCHEDULE C</b> <b>(Form 1040)</b></p> <p>Department of the Treasury Internal Revenue Service (99)</p>	<p><b>Profit or Loss from Business</b> <b>(Sole Proprietorship)</b></p> <p>▶ Partnerships, joint ventures, etc., must file Form 1065 or Form 1065-B.</p> <p>▶ Attach to Form 1040 or Form 1041. ▶ See Instructions for Schedule C (Form 1040).</p>	<p>OMB No. 1545-0074</p> <p><b>1998</b></p> <p>Attachment Sequence No. <b>09</b></p>	
<p>Name of proprietor <b>JOHN M. MARTIN</b></p>		<p>Social security number (SSN) <b>123 00 1234</b></p>	
<p><b>A</b> Principal business or profession, including product or service (see page C-1) <b>RETAIL FURNITURE</b></p>		<p><b>B</b> Enter NEW code from pages C-8 &amp; 9 ▶ <b>1442110</b></p>	
<p><b>C</b> Business name. If no separate business name, leave blank. <b>JOHN'S FURNITURE STORE</b></p>		<p><b>D</b> Employer ID number (EIN), if any <b>1000101010</b></p>	
<p><b>E</b> Business address (including suite or room no.) ▶ <b>23 VALLEY ST.</b> City, town or post office, state, and ZIP code <b>LAKE CITY, MD 21235</b></p>			
<p><b>F</b> Accounting method: (1) <input type="checkbox"/> Cash (2) <input checked="" type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶</p>			
<p><b>G</b> Did you "materially participate" in the operation of this business during 1998? If "No," see page C-2 for limit on losses . <input type="checkbox"/> Yes <input type="checkbox"/> No</p>			
<p><b>H</b> If you started or acquired this business during 1998, check here . . . . . <input type="checkbox"/></p>			
<b>Part I Income</b>			
<p><b>1</b> Gross receipts or sales. <b>Caution:</b> If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see page C-3 and check here . . . . . <input type="checkbox"/></p>	1	48,000	00
<b>2</b> Returns and allowances . . . . .	2		
<b>3</b> Subtract line 2 from line 1 . . . . .	3	48,000	00
<b>4</b> Cost of goods sold (from line 42 on page 2) . . . . .	4	28,200	00
<b>5</b> Gross profit. Subtract line 4 from line 3 . . . . .	5	19,800	00
<b>6</b> Other income, including Federal and state gasoline or fuel tax credit or refund (see page C-3) . . . . .	6		
<b>7</b> Gross income. Add lines 5 and 6 . . . . .	7	19,800	00
<b>Part II Expenses.</b> Enter expenses for business use of your home <b>only</b> on line 30.			
<b>8</b> Advertising . . . . .	8	200	00
<b>9</b> Bad debts from sales or services (see page C-3) . . . . .	9	150	00
<b>10</b> Car and truck expenses (see page C-3) . . . . .	10	2000	00
<b>11</b> Commissions and fees . . . . .	11		
<b>12</b> Depletion . . . . .	12		
<b>13</b> Depreciation and section 179 expense deduction (not included in Part III) (see page C-4) . . . . .	13	200	00
<b>14</b> Employee benefit programs (other than on line 19) . . . . .	14		
<b>15</b> Insurance (other than health) . . . . .	15	1000	00
<b>16</b> Interest:			
<b>16a</b> Mortgage (paid to banks, etc.) . . . . .	16a		
<b>16b</b> Other . . . . .	16b		
<b>17</b> Legal and professional services . . . . .	17		
<b>18</b> Office expense . . . . .	18	300	00
<b>19</b> Pension and profit-sharing plans . . . . .	19		
<b>20</b> Rent or lease (see page C-5):			
<b>20a</b> Vehicles, machinery, and equipment . . . . .	20a		
<b>20b</b> Other business property . . . . .	20b		
<b>21</b> Repairs and maintenance . . . . .	21	300	00
<b>22</b> Supplies (not included in Part III) . . . . .	22		
<b>23</b> Taxes and licenses . . . . .	23	1300	00
<b>24</b> Travel, meals, and entertainment:			
<b>24a</b> Travel . . . . .	24a		
<b>24b</b> Meals and entertainment . . . . .	24b		
<b>24c</b> Enter 50% of line 24b subject to limitations (see page C-6) . . . . .	24c		
<b>24d</b> Subtract line 24c from line 24b . . . . .	24d		
<b>25</b> Utilities . . . . .	25	500	00
<b>26</b> Wages (less employment credits) . . . . .	26	5000	00
<b>27</b> Other expenses (from line 48 on page 2) . . . . .	27	50	00
<b>28</b> Total expenses before expenses for business use of home. Add lines 8 through 27 in columns . . . . .	28	11,000	00
<b>29</b> Tentative profit (loss). Subtract line 28 from line 7 . . . . .	29	8,800	00
<b>30</b> Expenses for business use of your home. Attach Form 8829 . . . . .	30		
<b>31</b> Net profit or (loss). Subtract line 30 from line 29.			
• If a profit, enter on Form 1040, line 12, and ALSO on Schedule SE, line 2 (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3.			
• If a loss, you MUST go on to line 32.			
<b>32</b> If you have a loss, check the box that describes your investment in this activity (see page C-6).			
• If you checked 32a, enter the loss on Form 1040, line 12, and ALSO on Schedule SE, line 2 (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3.			
• If you checked 32b, you MUST attach Form 6198.			
	31	8,800	00
		32a	<input type="checkbox"/> All investment is at risk.
		32b	<input type="checkbox"/> Some investment is not at risk.
For Paperwork Reduction Act Notice, see Form 1040 instructions.		Cat. No. 11334P Schedule C (Form 1040) 1998	



EXHIBIT 1.4 - SCHEDULE SE

<p><b>SCHEDULE SE</b> <b>(Form 1040)</b></p> <p>Department of the Treasury Internal Revenue Service</p>	<p><b>Self-Employment Tax</b></p> <p>▶ See Instructions for Schedule SE (Form 1040). ▶ Attach to Form 1040.</p>	<p>OMB No. 1545-0074</p> <p style="font-size: 2em; font-weight: bold;">1998</p> <p>Attachment Sequence No. 17</p>
<p>Name of person with self-employment income (as shown on Form 1040) <b>JOHN M. MARTIN</b></p>		<p>Social security number of person with self-employment income ▶ <b>123 00 1234</b></p>

**Who Must File Schedule SE**  
You must file Schedule SE if:

- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of \$400 or more, **OR**
- You had church employee income of \$108.28 or more. Income from services you performed as a minister or a member of a religious order is **not** church employee income. See page SE-1.

**Note:** Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE. See page SE-3.

**Exception.** If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner and you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt-Form 4361" on Form 1040, line 50.

**May I Use Short Schedule SE or MUST I Use Long Schedule SE?**

DID YOU RECEIVE WAGES OR TIPS IN 1998?

No

Are you a minister, member of a religious order, or Christian Science practitioner who received IRS approval **not** to be taxed on earnings from these sources, **but** you owe self-employment tax on other earnings?

No

Are you using one of the optional methods to figure your net earnings (see page SE-3)?

No

Did you receive church employee income reported on Form W-2 of \$108.28 or more?

No

YOU MAY USE SHORT SCHEDULE SE BELOW

Yes

Was the total of your wages and tips subject to social security or railroad retirement tax **plus** your net earnings from self-employment more than \$68,400?

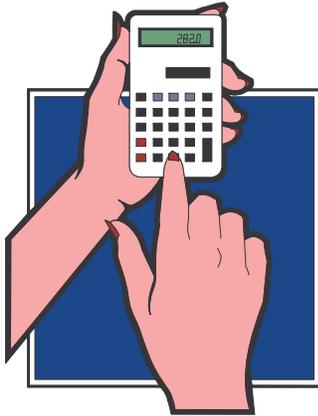
No

Did you receive tips subject to social security or Medicare tax that you **did not** report to your employer?

No

YOU MUST USE LONG SCHEDULE SE ON THE BACK

## Business deductions and credits



Both deductions and credits lower your tax. Deductions are subtracted from **income**, and credits are subtracted from **tax**.

The work opportunity credit (Form 5884) and the welfare-to-work credit (Form 8861) are of particular interest to those who already have, or are thinking about having, employees. The work opportunity credit provides an incentive to hire individuals from targeted groups that have a particularly high unemployment rate or other special employment needs. The amount of the credit depends on when the individual began working for you, generally after September 30, 1996 and before July 1, 1999. For more information, see Form 5884. The welfare-to-work credit is a new credit that you can take for qualified wages you pay to qualified long-term family assistance recipients who started working for you after December 31, 1997 and before July 1, 1999. For more information, see Form 8861.

You must receive certification from your state employment security agency before claiming either credit. Submit Form 8850, PRE-SCREENING NOTICE AND CERTIFICATION REQUEST FOR THE WORK OPPORTUNITY AND WELFARE-TO-WORK CREDITS, no later than 21 days after the employee begins working for you.

## Travel, transportation, and entertainment expenses

Travel expenses are the ordinary and necessary expenses you incur in traveling away from home in the course of your trade or business. These expenses include the cost of public transportation, operating and maintaining your car, meals and lodging, and other related expenses.

Transportation expenses are the ordinary and necessary expenses of getting from one workplace to another, in the course of your business or profession, while you are not away from home.

Business entertainment expenses are deductible only if they are ordinary and necessary expenses of carrying on your trade or business and you can prove them.

For more information, see Publication 334, and Publication 463, TRAVEL, ENTERTAINMENT, GIFT AND CAR EXPENSES.

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## Car expenses

If you use a car for business only, you may base your deduction on the full cost of operating it. If you use the car for both business and personal purposes, you must divide your expenses between those uses on the basis of mileage. Do not include commuting to and from work as business mileage.

You may take a deduction for your actual business expenses for the car, or use a standard mileage rate. Under either system, parking fees and tolls are deductible. Actual business expenses include gas, oil, repairs, insurance, depreciation, tires, and license plates. The standard mileage rate changed in 1999: 32.5¢ per business mile (Jan. 1–Mar. 31) and 31¢ per business mile (Apr. 1–Dec. 31).

For more information, refer to Publication 463 and Publication 946, *HOW TO DEPRECIATE PROPERTY*.

## Business use of your home

If you use part of your home in your business, you may be able to claim part of the expenses of maintaining your home as a business expense. These expenses include mortgage interest, insurance, utilities, repairs, and depreciation. The business use of your home must meet certain requirements before you can take any of these expenses as business deductions. Special rules apply if you use part of your home as a day care center or to store inventory.

If you are self-employed, use Schedule C (Form 1040), to deduct your expenses for business use of your home. An employee must use Schedule A (Form 1040), to itemize this deduction. For more information, see Publication 587, *BUSINESS USE OF YOUR HOME*, and Lesson 4 in this workbook.

## Retirement plans

If you establish a retirement arrangement for yourself or any employees you have, you may be able to take a deduction for your contributions to the plan. The plans discussed here are popular among people with small businesses.

As a plan for yourself, you can establish a traditional individual retirement arrangement (IRA) or the new Roth IRA. If you are a sole proprietor or a member of a partnership, you can have a self-employed plan (called a Keogh). You are not taxed on certain amounts you pay into the plan, or on the plan's earnings, until they are distributed to you in future years. If you have employees, you usually include them in your Keogh.

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If you have employees, they can set up simplified employee pensions (SEPs). A SEP is a kind of IRA that was designed for small employers and has very few administrative burdens or costs. You make the contributions for your employees and deduct certain payments you make to it.

Generally, you can set up a savings incentive match for employees (SIMPLE) plan if you have 100 or fewer employees and meet several other requirements. Under this plan, the employer makes contributions to employees' IRAs. The two types of plans are the SIMPLE IRA and SIMPLE 401(k).

For more information, see Publication 590, **INDIVIDUAL RETIREMENT ARRANGEMENTS (IRAs) (INCLUDING ROTH AND EDUCATION IRAs)** and Publication 560, **RETIREMENT PLANS FOR SMALL BUSINESS (SEP, KEOGH, AND SIMPLE PLANS)**.

### **Health insurance deduction for the self-employed**

You may be able to deduct 60% of the amount you paid for medical insurance for yourself and your family. You deduct this amount on line 28 of Form 1040 (1998). For more information, see Chapter 10 in Publication 535, **BUSINESS EXPENSES**.

### **Business start-up costs**

Start-up costs are those expenses that you have in connection with setting up an active trade or business, or for investigating the possibility of creating or acquiring an active trade or business. For more information, see Publication 535.

### **Depreciation—Section 179 Deduction**

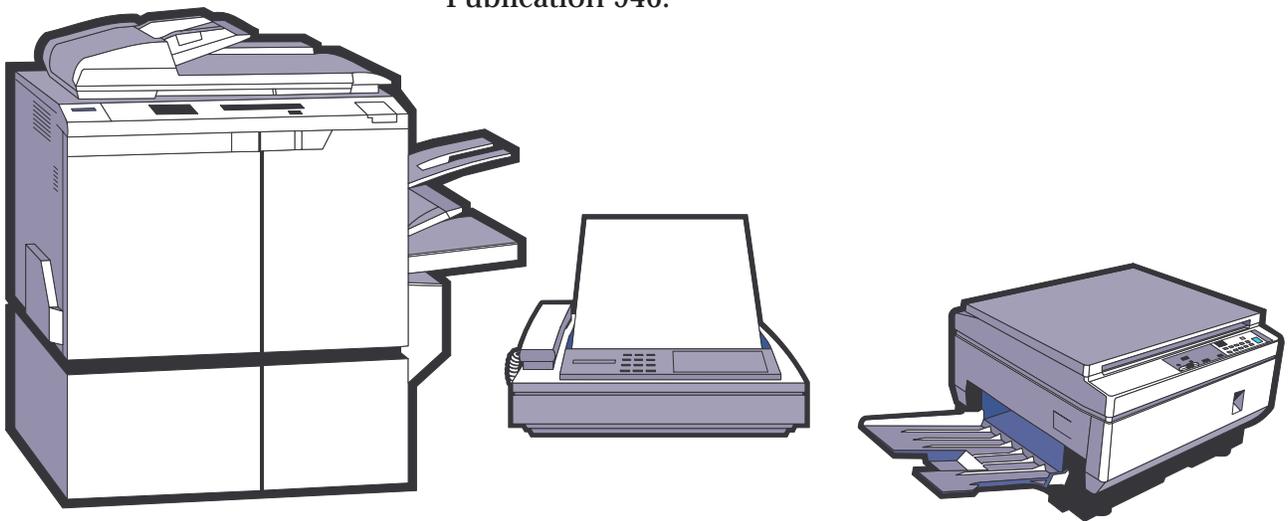
#### **Depreciation of business property**

If you buy business property that has a life of more than 1 year, you may deduct its cost or other basis over a number of years. This practice is called depreciation. Do not depreciate land, inventory, and property you placed in service and disposed of in the same year.

You can depreciate property that meets all of the following basic requirements:

- the property must be used in business or held for the production of income;
- the property must have a determinable useful life which must be longer than one year; and
- the property must be something that wears out, decays, gets used up, becomes obsolete, or loses value from natural causes.

The method for depreciating most tangible property placed in service after 1986 is called the Modified Accelerated Cost Recovery System (MACRS). Note: Tangible property is any property that can be seen or touched, like buildings, cars, machinery, or equipment. MACRS is discussed in detail in Publication 946.

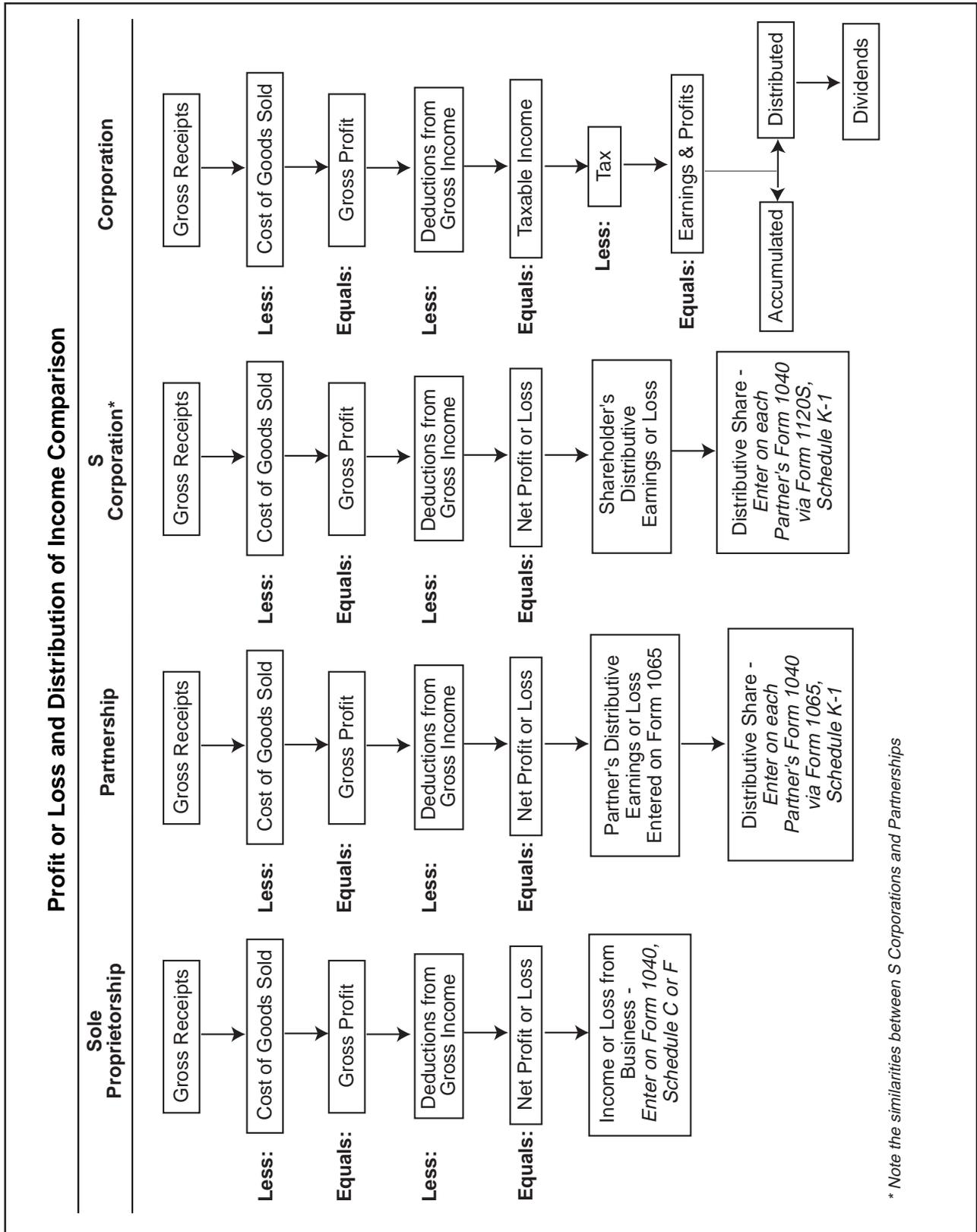


### Section 179 deduction

You can choose to deduct a limited amount (for 1999, up to \$19,000) of the cost of certain depreciable property in the year you buy it for use in your business. This deduction is known as the “section 179 deduction.” Use Form 4562, DEPRECIATION AND AMORTIZATION, to figure your section 179 deduction. Publication 946 explains what costs you can and cannot deduct, how to figure the deduction, and when to recapture the deduction.

For more information on credits and deductions, see Publication 535, or the specific publication for the deduction or credit you want to take. (See Tax Publications and Forms at the end of this lesson.)

EXHIBIT 1.5 - PROFIT OR LOSS AND DISTRIBUTION OF INCOME COMPARISON



\* Note the similarities between S Corporations and Partnerships

## Tax publications and forms

All IRS forms and publications can be downloaded from the INTERNET at [www.irs.ustreas.gov/prod/forms\\_pubs/index.html](http://www.irs.ustreas.gov/prod/forms_pubs/index.html) or ordered free by calling 1-800-829-3676. Or, you can buy a CD-ROM of current and prior year tax forms and publications from the National Technical Information Service (toll free at 1-877-233-6767 or on-line at [www.irs.ustreas.gov/cdorders](http://www.irs.ustreas.gov/cdorders)). You can also get forms via fax (from your fax machine dial (703) 368-9694).

The following are the most popular business publications and related forms:

Publication 1, YOUR RIGHTS AS A TAXPAYER

Publication 15, Circular E, EMPLOYER'S TAX GUIDE

**Forms 940, 941**

Publication 15-A, EMPLOYER'S SUPPLEMENTAL TAX GUIDE

Publication 51, Circular A, AGRICULTURAL EMPLOYER'S TAX GUIDE

**Form 943**

Publication 225, FARMER'S TAX GUIDE

**Forms 1040 (Schedules A, D, F, J, SE), 4136, 4562, 4684, 4797, 6251**

Publication 334, TAX GUIDE FOR SMALL BUSINESS (FOR INDIVIDUALS WHO USE SCHEDULE C OR C-EZ)

**Form 1040 (Schedules C, C-EZ)**

Publication 378, FUEL TAX CREDITS AND REFUNDS

**Forms 720, 4136, 8849**

Publication 463, TRAVEL, ENTERTAINMENT, GIFT, AND CAR EXPENSES

**Forms 2106, 2106EZ**

Publication 505, TAX WITHHOLDING AND ESTIMATED TAX

**Forms 1040-ES, 2210, 2210F, W-4, W-4P**

Publication 509, TAX CALENDARS FOR 1999

Publication 510, EXCISE TAXES FOR 1999

**Forms 11-C, 637, 720, 730, 6197, 6627**

Publication 533, SELF-EMPLOYMENT TAX

**Form 1040 (Schedule SE)**

Publication 534, DEPRECIATING PROPERTY PLACED IN SERVICE BEFORE 1987

**Form 4562**

Publication 535, BUSINESS EXPENSES

Publication 536, NET OPERATING LOSSES

**Form 1045**

Publication 537, INSTALLMENT SALES

**Form 6252**

Publication 538, ACCOUNTING PERIODS AND METHODS

Publication 541, PARTNERSHIPS

**Form 1065 (Schedule K-1)**

Publication 542, CORPORATIONS

**Forms 1120, 1120-A**

Publication 544, SALES AND OTHER DISPOSITIONS OF ASSETS

**Form 1040 (Schedule D), 4797, 8824**Publication 547, CASUALTIES, DISASTERS AND THEFTS  
(BUSINESS & NON-BUSINESS)

Publication 551, BASIS OF ASSETS

Publication 552, RECORDKEEPING FOR INDIVIDUALS

Publication 553, HIGHLIGHTS OF 1998 TAX CHANGES

Publication 556, EXAMINATION OF RETURNS, APPEAL RIGHTS, AND  
CLAIMS FOR REFUND

Publication 557, TAX-EXEMPT STATUS FOR YOUR ORGANIZATIONS

**Forms 990, 990EZ, 990PF, 1023, 1024**

Publication 560, RETIREMENT PLANS FOR SMALL BUSINESS

**Forms 5305-SEP, 5304-SIMPLE, 5305-SIMPLE, and 5500EZ**

Publication 564, MUTUAL FUND DISTRIBUTIONS

**Forms 1040, (Schedules B, D), 1099-DIV**

Publication 575, PENSION AND ANNUITY INCOME

**Forms 1040, 1040A, 1099-R, 4972**

Publication 583, STARTING A BUSINESS AND KEEPING RECORDS

Publication 587, BUSINESS USE OF YOUR HOME  
(INCLUDING USE BY DAY-CARE PROVIDERS)**Form 8829**Publication 590, INDIVIDUAL RETIREMENT ARRANGEMENTS (IRAs)  
(INCLUDING ROTH IRAs AND EDUCATION IRAs)**Forms 1040, 1040A, 1099-R, 5329, 8606**

Publication 594, THE IRS COLLECTION PROCESS

Publication 595, TAX HIGHLIGHTS FOR COMMERCIAL FISHERMEN

**Forms 1040 (Schedule C), 1099-MISC**

Publication 598, TAX ON UNRELATED BUSINESS INCOME OF EXEMPT ORGANIZATIONS

**Form 990-T**

Publication 908, BANKRUPTCY TAX GUIDE

**Forms 982, 1040, 1041**

Publication 910, GUIDE TO FREE TAX SERVICES

Publication 911, DIRECT SELLERS

Form 1040 (Schedules C, SE)

Publication 925, PASSIVE ACTIVITY AND AT-RISK RULES

**Form 8582**

Publication 939, GENERAL RULE FOR PENSIONS AND ANNUITIES

Publication 946, HOW TO DEPRECIATE PROPERTY

**Form 4562**

Publication 947, PRACTICE BEFORE THE IRS AND POWER OF ATTORNEY

**Forms 2848, 8821**

Publication 953, INTERNATIONAL TAX INFORMATION FOR BUSINESSES

Publication 1244, EMPLOYEE'S DAILY RECORD OF TIPS AND REPORT TO EMPLOYERS

**Forms 4070, 4070-A**

Publication 1518, TAX CALENDAR FOR SMALL BUSINESS

Publication 1542, PER DIEM RATES

Publication 1544, REPORTING CASH PAYMENTS OF OVER \$10,000 (RECEIVED IN A TRADE OR BUSINESS)

**Form 8300**

Publication 1546, THE PROBLEM RESOLUTION PROGRAM OF THE INTERNAL REVENUE SERVICE

## LESSON 2

# Employment Taxes

## Introduction

This lesson introduces federal employment taxes. It briefly explains your responsibilities as an employer to withhold and pay these taxes, and it gives other related information. Employment taxes represent the income tax and social security and Medicare taxes (FICA taxes) withheld from the wages of an employee plus the employer's share of social security taxes and Federal Unemployment (FUTA) taxes. The withheld (employee's) portion of employment taxes is referred to as "trust fund" taxes.



## Objectives

At the end of this lesson you will be able to:

1. Determine an employer's responsibility for Income tax withholding, social security and Medicare (FICA) taxes, and Federal Unemployment (FUTA) taxes.
2. Determine the need for various forms related to employment taxes.
3. Determine the need for forms related to non-employee/miscellaneous payments.

## Employer Identification Number (EIN)

When you start or buy a business, you may need to apply for an EIN to identify the tax returns of your business. If you don't already have an EIN, you need to get one if you:

- pay wages to employees,
- are required to withhold taxes for nonemployment purposes,
- have a Keogh plan,
- operate your business as a corporation or partnership, or
- file any of these tax returns:
  - employment,
  - excise,
  - fiduciary, or
  - alcohol, tobacco, and firearms.



**Note:** *If you are a sole proprietor with no employees and none of the listed filing requirements, you do not need an EIN. If you need a number solely to identify your business's bank account, do not apply for an EIN but use your social security number (SSN) instead. This will save both you and IRS paperwork and unnecessary correspondence.*



## Form SS-4

If you have not applied for an EIN and you are required to have one, you should obtain Form SS-4, APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER, from IRS or the nearest Social Security Administration (SSA) office. (See Exhibit 2.1.) The completed application should be filed with the Internal Revenue Service Center where you file your federal tax returns.

Use your identification number on all the items you send to IRS and SSA.



You should have only one EIN for yourself as a sole proprietor. For example, if you operate more than one sole proprietorship, you must use the same number for each. If you take over another employer's sole proprietorship, do not use that employer's EIN. Use your EIN or apply for one.

Once you have received an EIN, you can use it from one year to the next. If you change your business from a sole proprietorship, for example, to a corporation or partnership, apply for a new EIN. If you don't have your number by the time a return is due, write "Applied for" and the date applied for in the EIN space.

**Note: Each separate partnership and corporation must have its own EIN.**

Fill out the SS-4 with the information requested in each box.

Because it takes several weeks to receive an EIN after the Form SS-4 is filed, apply for your EIN well before your tax returns are due. You can also obtain an EIN by telephone. See the Instructions for Form SS-4 and Publication 1635, UNDERSTANDING YOUR EIN, for more information.

EXHIBIT 2.1 - FORM SS-4

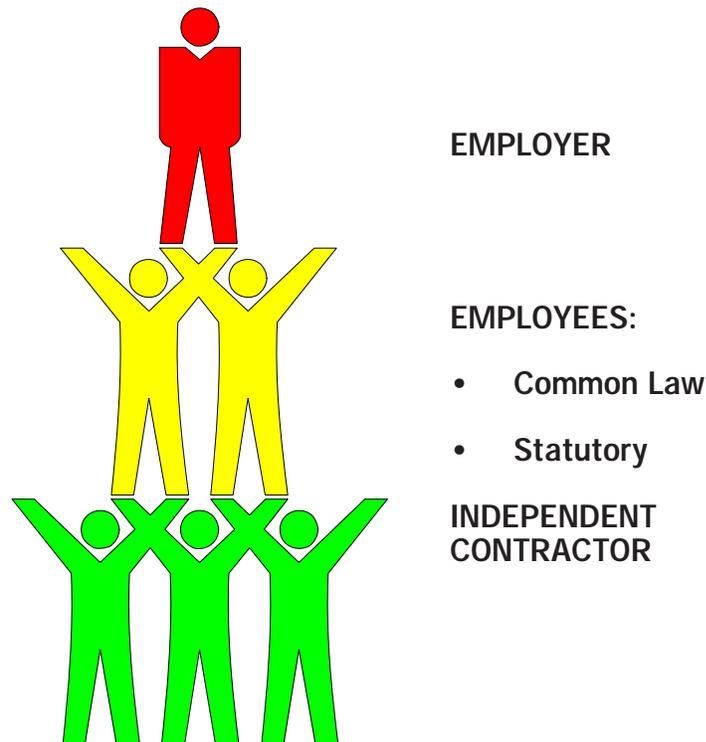
Form <b>SS-4</b> (Rev. February 1998) Department of the Treasury Internal Revenue Service	<b>Application for Employer Identification Number</b> (For use by employers, corporations, partnerships, trusts, estates, churches, government agencies, certain individuals, and others. See instructions.) ► <b>Keep a copy for your records.</b>	EIN _____  OMB No. 1545-0003																					
Please type or print clearly.	1 Name of applicant (legal name) (see instructions)																						
	2 Trade name of business (if different from name on line 1)	3 Executor, trustee, "care of" name																					
	4a Mailing address (street address) (room, apt., or suite no.)	5a Business address (if different from address on lines 4a and 4b)																					
	4b City, state, and ZIP code	5b City, state, and ZIP code																					
	6 County and state where principal business is located																						
	7 Name of principal officer, general partner, grantor, owner, or trustor—SSN or ITIN may be required (see instructions) ► _____																						
	8a Type of entity (Check only one box.) (see instructions) <b>Caution:</b> If applicant is a limited liability company, see the instructions for line 8a.																						
<table style="width:100%; border: none;"> <tr> <td style="width:33%; border: none;"><input type="checkbox"/> Sole proprietor (SSN) _____</td> <td style="width:33%; border: none;"><input type="checkbox"/> Estate (SSN of decedent) _____</td> <td style="width:33%; border: none;"></td> </tr> <tr> <td style="border: none;"><input type="checkbox"/> Partnership</td> <td style="border: none;"><input type="checkbox"/> Personal service corp.</td> <td style="border: none;"><input type="checkbox"/> Plan administrator (SSN) _____</td> </tr> <tr> <td style="border: none;"><input type="checkbox"/> REMIC</td> <td style="border: none;"><input type="checkbox"/> National Guard</td> <td style="border: none;"><input type="checkbox"/> Other corporation (specify) ► _____</td> </tr> <tr> <td style="border: none;"><input type="checkbox"/> State/local government</td> <td style="border: none;"><input type="checkbox"/> Farmers' cooperative</td> <td style="border: none;"><input type="checkbox"/> Trust</td> </tr> <tr> <td style="border: none;"><input type="checkbox"/> Church or church-controlled organization</td> <td colspan="2" style="border: none;"><input type="checkbox"/> Federal government/military</td> </tr> <tr> <td colspan="3" style="border: none;"><input type="checkbox"/> Other nonprofit organization (specify) ► _____ (enter GEN if applicable)</td> </tr> <tr> <td colspan="3" style="border: none;"><input type="checkbox"/> Other (specify) ► _____</td> </tr> </table>			<input type="checkbox"/> Sole proprietor (SSN) _____	<input type="checkbox"/> Estate (SSN of decedent) _____		<input type="checkbox"/> Partnership	<input type="checkbox"/> Personal service corp.	<input type="checkbox"/> Plan administrator (SSN) _____	<input type="checkbox"/> REMIC	<input type="checkbox"/> National Guard	<input type="checkbox"/> Other corporation (specify) ► _____	<input type="checkbox"/> State/local government	<input type="checkbox"/> Farmers' cooperative	<input type="checkbox"/> Trust	<input type="checkbox"/> Church or church-controlled organization	<input type="checkbox"/> Federal government/military		<input type="checkbox"/> Other nonprofit organization (specify) ► _____ (enter GEN if applicable)			<input type="checkbox"/> Other (specify) ► _____		
<input type="checkbox"/> Sole proprietor (SSN) _____	<input type="checkbox"/> Estate (SSN of decedent) _____																						
<input type="checkbox"/> Partnership	<input type="checkbox"/> Personal service corp.	<input type="checkbox"/> Plan administrator (SSN) _____																					
<input type="checkbox"/> REMIC	<input type="checkbox"/> National Guard	<input type="checkbox"/> Other corporation (specify) ► _____																					
<input type="checkbox"/> State/local government	<input type="checkbox"/> Farmers' cooperative	<input type="checkbox"/> Trust																					
<input type="checkbox"/> Church or church-controlled organization	<input type="checkbox"/> Federal government/military																						
<input type="checkbox"/> Other nonprofit organization (specify) ► _____ (enter GEN if applicable)																							
<input type="checkbox"/> Other (specify) ► _____																							
8b If a corporation, name the state or foreign country (if applicable) where incorporated <table style="width:100%; border: none;"> <tr> <td style="width:40%; border: none;">State _____</td> <td style="width:60%; border: none;">Foreign country _____</td> </tr> </table>			State _____	Foreign country _____																			
State _____	Foreign country _____																						
9 Reason for applying (Check only one box.) (see instructions) <table style="width:100%; border: none;"> <tr> <td style="width:50%; border: none;"><input type="checkbox"/> Started new business (specify type) ► _____</td> <td style="width:50%; border: none;"><input type="checkbox"/> Banking purpose (specify purpose) ► _____</td> </tr> <tr> <td style="border: none;"><input type="checkbox"/> Hired employees (Check the box and see line 12.)</td> <td style="border: none;"><input type="checkbox"/> Changed type of organization (specify new type) ► _____</td> </tr> <tr> <td style="border: none;"><input type="checkbox"/> Created a pension plan (specify type) ► _____</td> <td style="border: none;"><input type="checkbox"/> Purchased going business</td> </tr> <tr> <td style="border: none;"></td> <td style="border: none;"><input type="checkbox"/> Created a trust (specify type) ► _____</td> </tr> <tr> <td colspan="2" style="border: none;"><input type="checkbox"/> Other (specify) ► _____</td> </tr> </table>			<input type="checkbox"/> Started new business (specify type) ► _____	<input type="checkbox"/> Banking purpose (specify purpose) ► _____	<input type="checkbox"/> Hired employees (Check the box and see line 12.)	<input type="checkbox"/> Changed type of organization (specify new type) ► _____	<input type="checkbox"/> Created a pension plan (specify type) ► _____	<input type="checkbox"/> Purchased going business		<input type="checkbox"/> Created a trust (specify type) ► _____	<input type="checkbox"/> Other (specify) ► _____												
<input type="checkbox"/> Started new business (specify type) ► _____	<input type="checkbox"/> Banking purpose (specify purpose) ► _____																						
<input type="checkbox"/> Hired employees (Check the box and see line 12.)	<input type="checkbox"/> Changed type of organization (specify new type) ► _____																						
<input type="checkbox"/> Created a pension plan (specify type) ► _____	<input type="checkbox"/> Purchased going business																						
	<input type="checkbox"/> Created a trust (specify type) ► _____																						
<input type="checkbox"/> Other (specify) ► _____																							
10 Date business started or acquired (month, day, year) (see instructions)		11 Closing month of accounting year (see instructions)																					
12 First date wages or annuities were paid or will be paid (month, day, year). <b>Note:</b> If applicant is a withholding agent, enter date income will first be paid to nonresident alien. (month, day, year) . . . . . ►																							
13 Highest number of employees expected in the next 12 months. <b>Note:</b> If the applicant does not expect to have any employees during the period, enter -0-. (see instructions) . . . . . ►																							
14 Principal activity (see instructions) ►																							
15 Is the principal business activity manufacturing? . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," principal product and raw material used ►																							
16 To whom are most of the products or services sold? Please check one box. <input type="checkbox"/> Business (wholesale) <input type="checkbox"/> N/A <input type="checkbox"/> Public (retail) <input type="checkbox"/> Other (specify) ►																							
17a Has the applicant ever applied for an employer identification number for this or any other business? . . . . . <input type="checkbox"/> Yes <input type="checkbox"/> No <b>Note:</b> If "Yes," please complete lines 17b and 17c.																							
17b If you checked "Yes" on line 17a, give applicant's legal name and trade name shown on prior application, if different from line 1 or 2 above. Legal name ► _____ Trade name ► _____																							
17c Approximate date when and city and state where the application was filed. Enter previous employer identification number if known. Approximate date when filed (mo., day, year)   City and state where filed   Previous EIN _____																							
Under penalties of perjury, I declare that I have examined this application and to the best of my knowledge and belief, it is true, correct, and complete.		Business telephone number (include area code) _____																					
Name and title (Please type or print clearly.) ► _____		Fax telephone number (include area code) _____																					
Signature ► _____		Date ► _____																					
<b>Note: Do not write below this line. For official use only.</b>																							
Please leave blank ►	Geo. _____	Ind. _____																					
	Class _____	Size _____																					
	Reason for applying _____																						
For Paperwork Reduction Act Notice, see page 4.																							
Cat. No. 16055N		Form <b>SS-4</b> (Rev. 2-98)																					

## Employer/ Employees

It is important to know whether you are considered an employer for tax purposes. A person or organization may be an employer for purposes of one kind of tax but not for another. A person who works for you may be classified as a common-law employee, a statutory employee, or an independent contractor. The classification of the person determines which forms you must file or which taxes you must pay. For a complete definition of these classifications, see Publication 15-A, *EMPLOYER'S SUPPLEMENTAL TAX GUIDE*.

Anyone who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed. Publication 15-A has more information on how to determine whether an individual providing services is an independent contractor or an employee.

To get a determination from the IRS as to whether or not a worker is an employee for purposes of Federal employment taxes and income tax withholding, file Form SS-8, *DETERMINATION OF EMPLOYEE WORK STATUS FOR PURPOSES OF FEDERAL EMPLOYMENT TAXES AND INCOME TAX WITHHOLDING*, with your district IRS office.



## Independent contractors

An *independent contractor* performs services for you, but is not under your direct control. Generally, people in business for themselves are not employees. For example, doctors, lawyers, veterinarians, construction contractors and others in an independent trade in which they offer their services to the public are usually not employees. However, whether such people are employees or independent contractors depends on the facts in each case. The general rule is that an individual is an independent contractor if you, the employer, have the right to control or direct only the result of the work and not the means and methods of accomplishing the result.

See Publication 15-A for more information.



## Form W-4

To know how much federal income tax to withhold from an employee's wages, you should have a Form W-4, Employee's Withholding Allowance Certificate, on file for each employee. The amount to be withheld is determined by the employee's gross wages and the information submitted by the employee on Form W-4. (See Exhibit 2.2.)

This information includes:

- employee's marital status;
- number of withholding allowances claimed;
- employee's request to have additional tax withheld; and
- employee's claim to exemption from withholding.

Ask each new employee to give you a signed Form W-4 by his or her first day of work. This certificate is effective with the first wage payment and will last until the employee files a new certificate.

If an employee does not give you a Form W-4, withhold tax as if the employee were a single person who has claimed no withholding allowances. If not enough tax is withheld and your employee has not provided a Form W-4 or has claimed an exemption from withholding, he or she may be subject to penalties. An employee who claims exemption from withholding must renew his or her status by filing a new Form W-4 with you by February 15 of each year.

**Note:** *Student status does not automatically exempt the employee from income tax withholding.*

Generally, Forms W-4 are for your records. They need not be sent to IRS unless:

- the employee claims more than 10 withholding allowances, or
- the employee normally earns more than \$200 per week and claims *exemption from withholding* on Line 7.

For more information on withholding, see Publication 505, TAX WITHHOLDING AND ESTIMATED TAX. You can help your employees determine whether they are having the right amount of income tax withheld by ordering copies of Publication 919, IS MY WITHHOLDING CORRECT?

EXHIBIT 2.2 - FORM W-4, FRONT PAGE

**Form W-4 (1999)**

**Purpose.** Complete Form W-4 so your employer can withhold the correct Federal income tax from your pay. Because your tax situation may change, you may want to refigure your withholding each year.

**Exemption from withholding.** If you are exempt, complete only lines 1, 2, 3, 4, and 7, and sign the form to validate it. Your exemption for 1999 expires February 16, 2000.

**Note:** You cannot claim exemption from withholding if (1) your income exceeds \$700 and includes more than \$250 of unearned income (e.g., interest and dividends) and (2) another person can claim you as a dependent on their tax return.

**Basic instructions.** If you are not exempt, complete the Personal Allowances Worksheet. The worksheets on page 2 adjust your withholding allowances based on itemized

deductions, adjustments to income, or two-earner/two-job situations. Complete all worksheets that apply. They will help you figure the number of withholding allowances you are entitled to claim. **However, you may claim fewer allowances.**

**Child tax and higher education credits.** For details on adjusting withholding for these and other credits, see **Pub. 919, Is My Withholding Correct for 1999?**

**Head of household.** Generally, you may claim head of household filing status on your tax return only if you are unmarried and pay more than 50% of the costs of keeping up a home for yourself and your dependent(s) or other qualifying individuals. See line E below.

**Nonwage income.** If you have a large amount of nonwage income, such as interest or dividends, you should consider making estimated tax payments using Form 1040-ES. Otherwise, you may owe additional tax.

**Two earners/two jobs.** If you have a working spouse or more than one job, figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one Form W-4. Your withholding will usually be most accurate when all allowances are claimed on the Form W-4 prepared for the highest paying job and zero allowances are claimed for the others.

**Check your withholding.** After your Form W-4 takes effect, use **Pub. 919** to see how the dollar amount you are having withheld compares to your estimated total annual tax. Get **Pub. 919** especially if you used the Two-Earner/Two-Job Worksheet and your earnings exceed \$150,000 (Single) or \$200,000 (Married).

**Recent name change?** If your name on line 1 differs from that shown on your social security card, call 1-800-772-1213 for a new social security card.

**Personal Allowances Worksheet**

**A** Enter "1" for yourself if no one else can claim you as a dependent . . . . . **A** \_\_\_\_\_

**B** Enter "1" if:   
 • You are single and have only one job; or   
 • You are married, have only one job, and your spouse does not work; or   
 • Your wages from a second job or your spouse's wages (or the total of both) are \$1,000 or less. . . . . **B** \_\_\_\_\_

**C** Enter "1" for your spouse. But, you may choose to enter -0- if you are married and have either a working spouse or more than one job. (This may help you avoid having too little tax withheld.) . . . . . **C** \_\_\_\_\_

**D** Enter number of dependents (other than your spouse or yourself) you will claim on your tax return . . . . . **D** \_\_\_\_\_

**E** Enter "1" if you will file as head of household on your tax return (see conditions under **Head of household** above) . . . . . **E** \_\_\_\_\_

**F** Enter "1" if you have at least \$1,500 of child or dependent care expenses for which you plan to claim a credit . . . . . **F** \_\_\_\_\_

**G Child Tax Credit:** • If your total income will be between \$20,000 and \$50,000 (\$23,000 and \$63,000 if married), enter "1" for each eligible child. • If your total income will be between \$50,000 and \$80,000 (\$63,000 and \$115,000 if married), enter "1" if you have two eligible children, enter "2" if you have three or four eligible children, or enter "3" if you have five or more eligible children . . . . . **G** \_\_\_\_\_

**H** Add lines A through G and enter total here. **Note:** This amount may be different from the number of exemptions you claim on your return. **H** \_\_\_\_\_

For accuracy, complete all worksheets that apply.   
 • If you plan to itemize or claim adjustments to income and want to reduce your withholding, see the Deductions and Adjustments Worksheet on page 2.   
 • If you are single, have more than one job and your combined earnings from all jobs exceed \$32,000, OR if you are married and have a working spouse or more than one job and the combined earnings from all jobs exceed \$55,000, see the Two-Earner/Two-Job Worksheet on page 2 to avoid having too little tax withheld.   
 • If neither of the above situations applies, stop here and enter the number from line H on line 5 of Form W-4 below.

Cut here and give the certificate to your employer. Keep the top part for your records.

<p><b>Form W-4</b> Department of the Treasury Internal Revenue Service</p>		<p><b>Employee's Withholding Allowance Certificate</b></p> <p>► For Privacy Act and Paperwork Reduction Act Notice, see page 2.</p>		<p>OMB No. 1545-0040 <b>1999</b></p>
1 Type or print your first name and middle initial		Last name		2 Your social security number
Home address (number and street or rural route)		3 <input type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. <i>Note: If married, but legally separated, or spouse is a nonresident alien, check the Single box.</i>		
City or town, state, and ZIP code		4 If your last name differs from that on your social security card, check here. You must call 1-800-772-1213 for a new card . . . . . <input type="checkbox"/>		
5 Total number of allowances you are claiming (from line H above or from the worksheets on page 2 if they apply)				5
6 Additional amount, if any, you want withheld from each paycheck				6 \$
7 I claim exemption from withholding for 1999, and I certify that I meet BOTH of the following conditions for exemption: • Last year I had a right to a refund of ALL Federal income tax withheld because I had NO tax liability AND • This year I expect a refund of ALL Federal income tax withheld because I expect to have NO tax liability. If you meet both conditions, write "EXEMPT" here . . . . .				7
Under penalties of perjury, I certify that I am entitled to the number of withholding allowances claimed on this certificate, or I am entitled to claim exempt status.				
Employee's signature (Form is not valid unless you sign it) ►				Date ►
8 Employer's name and address (Employer: Complete 8 and 10 only if sending to the IRS)		9 Office code (optional)	10 Employer identification number	

EXHIBIT 2.2 - FORM W-4, BACK PAGE

Form W-4 (1999)
Page 4

### Deductions and Adjustments Worksheet

**Note:** Use this worksheet only if you plan to itemize deductions or claim adjustments to income on your 1999 tax return.

- 1 Enter an estimate of your 1999 itemized deductions. These include qualifying home mortgage interest, charitable contributions, state and local taxes (but not sales taxes), medical expenses in excess of 7.5% of your income, and miscellaneous deductions. (For 1999, you may have to reduce your itemized deductions if your income is over \$126,600 (\$63,300 if married filing separately). Get Pub. 919 for details.) 1 \$ \_\_\_\_\_
- 2 Enter:
 

}	\$7,200 if married filing jointly or qualifying widow(er)	}
	\$6,350 if head of household	
	\$4,300 if single	
	\$3,600 if married filing separately	

2 \$ \_\_\_\_\_
- 3 Subtract line 2 from line 1. If line 2 is greater than line 1, enter -0- 3 \$ \_\_\_\_\_
- 4 Enter an estimate of your 1999 adjustments to income, including alimony, deductible IRA contributions, and student loan interest 4 \$ \_\_\_\_\_
- 5 Add lines 3 and 4 and enter the total 5 \$ \_\_\_\_\_
- 6 Enter an estimate of your 1999 nonwage income (such as dividends or interest) 6 \$ \_\_\_\_\_
- 7 Subtract line 6 from line 5. Enter the result, but not less than -0- 7 \$ \_\_\_\_\_
- 8 Divide the amount on line 7 by \$3,000 and enter the result here. Drop any fraction 8 \_\_\_\_\_
- 9 Enter the number from Personal Allowances Worksheet, line H, on page 1 9 \_\_\_\_\_
- 10 Add lines 8 and 9 and enter the total here. If you plan to use the Two-Earner/Two-Job Worksheet, also enter this total on line 1 below. Otherwise, stop here and enter this total on Form W-4, line 5, on page 1. 10 \_\_\_\_\_

### Two-Earner/Two-Job Worksheet

**Note:** Use this worksheet only if the instructions for line H on page 1 direct you here.

- 1 Enter the number from line H on page 1 (or from line 10 above if you used the Deductions and Adjustments Worksheet) 1 \_\_\_\_\_
- 2 Find the number in Table 1 below that applies to the LOWEST paying job and enter it here 2 \_\_\_\_\_
- 3 If line 1 is GREATER THAN OR EQUAL TO line 2, subtract line 2 from line 1. Enter the result here (if zero, enter -0-) and on Form W-4, line 5, on page 1. DO NOT use the rest of this worksheet 3 \_\_\_\_\_

**Note:** If line 1 is LESS THAN line 2, enter -0- on Form W-4, line 5, on page 1. Complete lines 4-9 to calculate the additional withholding amount necessary to avoid a year end tax bill.

- 4 Enter the number from line 2 of this worksheet 4 \_\_\_\_\_
- 5 Enter the number from line 1 of this worksheet 5 \_\_\_\_\_
- 6 Subtract line 5 from line 4 6 \_\_\_\_\_
- 7 Find the amount in Table 2 below that applies to the HIGHEST paying job and enter it here 7 \$ \_\_\_\_\_
- 8 Multiply line 7 by line 6 and enter the result here. This is the additional annual withholding amount needed 8 \$ \_\_\_\_\_
- 9 Divide line 8 by the number of pay periods remaining in 1999. (For example, divide by 26 if you are paid every other week and you complete this form in December 1998.) Enter the result here and on Form W-4, line 6, page 1. This is the additional amount to be withheld from each paycheck 9 \$ \_\_\_\_\_

### Table 1: Two-Earner/Two-Job Worksheet

Married Filing Jointly				All Others			
If wages from LOWEST paying job are—	Enter on line 2 above	If wages from LOWEST paying job are—	Enter on line 2 above	If wages from LOWEST paying job are—	Enter on line 2 above	If wages from LOWEST paying job are—	Enter on line 2 above
\$0 - \$4,000	0	40,001 - 45,000	8	\$0 - \$5,000	0	65,001 - 80,000	8
4,001 - 7,000	1	45,001 - 54,000	9	5,001 - 11,000	1	80,001 - 100,000	9
7,001 - 12,000	2	54,001 - 62,000	10	11,001 - 16,000	2	100,001 and over	10
12,001 - 18,000	3	62,001 - 70,000	11	16,001 - 21,000	3		
18,001 - 24,000	4	70,001 - 85,000	12	21,001 - 25,000	4		
24,001 - 28,000	5	85,001 - 100,000	13	25,001 - 40,000	5		
28,001 - 35,000	6	100,001 - 110,000	14	40,001 - 50,000	6		
35,001 - 40,000	7	110,001 and over	15	50,001 - 65,000	7		

### Table 2: Two-Earner/Two-Job Worksheet

Married Filing Jointly		All Others	
If wages from HIGHEST paying job are—	Enter on line 7 above	If wages from HIGHEST paying job are—	Enter on line 7 above
\$0 - \$50,000	\$400	\$0 - \$30,000	\$400
50,001 - 100,000	770	30,001 - 60,000	770
100,001 - 130,000	850	60,001 - 120,000	850
130,001 - 240,000	1,000	120,001 - 250,000	1,000
240,001 and over	1,100	250,001 and over	1,100

**Privacy Act and Paperwork Reduction Act Notice.** We ask for the information on this form to carry out the Internal Revenue laws of the United States. The Internal Revenue Code requires this information under sections 3402(f)(2)(A) and 6109 and their regulations. Failure to provide a properly completed form will result in your being treated as a single person who claims no withholding allowances. Providing fraudulent information may also subject you to penalties. Routine uses of this information include giving it to the Department of Justice for civil and criminal litigation and to cities, states, and the District of Columbia for use in administering their tax laws.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is: Recordkeeping 46 min., Learning about the law or the form 10 min., Preparing the form 1 hr., 10 min. If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. DO NOT send the tax form to this address. Instead, give it to your employer.

# Form I-9

You must verify that each new employee is legally eligible to work in the United States. Both you and the employee must complete the Immigration and Naturalization Service (INS) Form I-9, EMPLOYMENT ELIGIBILITY VERIFICATION. (See Exhibit 2.3.) You can get the form from INS offices. Call the INS at 1-800-755-0777 for more information about your responsibilities.

## EXHIBIT 2.3 - FORM I-9

<b>U.S. Department of Justice</b> Immigration and Naturalization Service		OMB No. 1115-0136 <b>Employment Eligibility Verification</b>
<p>Please read instructions carefully before completing this form. The instructions must be available during completion of this form. <b>ANTI-DISCRIMINATION NOTICE.</b> It is illegal to discriminate against work eligible individuals. Employers <b>CANNOT</b> specify which document(s) they will accept from an employee. The refusal to hire an individual because of a future expiration date may also constitute illegal discrimination.</p>		
<b>Section 1. Employee Information and Verification.</b> To be completed and signed by employee at the time employment begins		
Print Name: Last	First	Middle Initial
Maiden Name		Date of Birth (month/day/year)
Address (Street Name and Number)		Apt. #
City	State	Zip Code
Social Security #		
<p>I am aware that federal law provides for imprisonment and/or fines for false statements or use of false documents in connection with the completion of this form.</p>		<p>I attest, under penalty of perjury, that I am (check one of the following):</p> <input type="checkbox"/> A citizen or national of the United States <input type="checkbox"/> A Lawful Permanent Resident (Alien # A _____) <input type="checkbox"/> An alien authorized to work until ____/____/____ (Alien # or Admission # _____)
Employee's Signature		Date (month/day/year)
<p><b>Preparer and/or Translator Certification.</b> (To be completed and signed if Section 1 is prepared by a person other than the employee.) I attest, under penalty of perjury, that I have assisted in the completion of this form and that to the best of my knowledge the information is true and correct.</p>		
Preparer's/Translator's Signature	Print Name	
Address (Street Name and Number, City, State, Zip Code)		Date (month/day/year)
<p><b>Section 2. Employer Review and Verification.</b> To be completed and signed by employer. Examine one document from List A OR examine one document from List B and one from List C as listed on the reverse of this form and record the title, number and expiration date, if any, of the document(s)</p>		
List A	OR	List B
AND	List C	
Document title: _____	_____	_____
Issuing authority: _____	_____	_____
Document #: _____	_____	_____
Expiration Date (if any): ____/____/____	____/____/____	____/____/____
Document #: _____	_____	_____
Expiration Date (if any): ____/____/____	_____	_____
<p><b>CERTIFICATION - I attest, under penalty of perjury, that I have examined the document(s) presented by the above-named employee, that the above-listed document(s) appear to be genuine and to relate to the employee named, that the employee began employment on (month/day/year) ____/____/____ and that to the best of my knowledge the employee is eligible to work in the United States. (State employment agencies may omit the date the employee began employment).</b></p>		
Signature of Employer or Authorized Representative	Print Name	Title
Business or Organization Name		Date (month/day/year)
Address (Street Name and Number, City, State, Zip Code)		
<b>Section 3. Updating and Reverification.</b> To be completed and signed by employer		
A. New Name (if applicable)	B. Date of rehire (month/day/year) (if applicable)	
C. If employee's previous grant of work authorization has expired, provide the information below for the document that establishes current employment eligibility.		
Document Title: _____	Document #: _____	Expiration Date (if any): ____/____/____
<p>I attest, under penalty of perjury, that to the best of my knowledge, this employee is eligible to work in the United States, and if the employee presented document(s), the document(s) I have examined appear to be genuine and to relate to the individual.</p>		
Signature of Employer or Authorized Representative		Date (month/day/year)
Form I-9 (Rev. 11-21-91) N		

## Information returns

### Form 1099-MISC

You do not withhold income tax or social security and Medicare taxes from, or pay social security and Medicare taxes or federal unemployment tax, on amounts you pay an independent contractor. Generally, if you pay at least \$600 during the year to an independent contractor for services performed in the course of your business, you must file a Form 1099-MISC (Miscellaneous Income). (See Exhibit 2.4.)

**Note: Do not report payments to corporations on Form 1099-MISC unless you are reporting payments for legal services to attorneys.**

EXHIBIT 2.4 - FORM 1099-MISC

9595 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED				OMB No. 1545-0115		<b>1999</b> <b>Miscellaneous Income</b>
PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Rents	\$	<b>Form 1099-MISC</b>		
		2 Royalties	\$			
		3 Other income	\$			
PAYER'S Federal identification number	RECIPIENT'S identification number	4 Federal income tax withheld	\$	5 Fishing boat proceeds	\$	<b>Copy A</b> <b>For Internal Revenue Service Center</b> <b>File with Form 1096.</b> <small>For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2C.</small>
RECIPIENT'S name		6 Medical and health care payments	\$	7 Nonemployee compensation	\$	
Street address (including apt. no.)		8 Substitute payments in lieu of dividends or interest	\$	9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>		
City, state, and ZIP code		10 Crop insurance proceeds	\$	11 State income tax withheld	\$	
Account number (optional)	2nd TIN Not <input type="checkbox"/>	12 State/Payer's state number		13	\$	
Form 1099-MISC		Cat. No. 14425J		Department of the Treasury - Internal Revenue Service		
<b>Do NOT Cut or Separate Forms on This Page</b>				<b>Do NOT Cut or Separate Forms on This Page</b>		

You will need the social security number or EIN of an independent contractor in order to complete Form 1099-MISC. If the independent contractor is a sole proprietor their SSN is preferred. Always ask the independent contractor to complete Form W-9, REQUEST FOR TAXPAYER IDENTIFICATION NUMBER AND CERTIFICATION, before beginning work. (See Exhibit 2.5.) If you do not obtain a signed Form W-9 before you pay the contractor, you must withhold income tax from the payment. This is called *backup withholding*. Backup withholding rules require that 31% of the payment be withheld. Report the backup withholding on Form 945, ANNUAL RETURN OF WITHHELD FEDERAL INCOME TAX, discussed in Lesson 3.

EXHIBIT 2.5 - FORM W-9

Form <b>W-9</b> (Rev. December 1996) Department of the Treasury Internal Revenue Service	<b>Request for Taxpayer                  Identification Number and Certification</b>	<b>Give form to the                  requester. Do NOT                  send to the IRS.</b>
Please print or type	Name (If a joint account or you changed your name, see <b>Specific Instructions</b> on page 2.)	
	Business name, if different from above. (See <b>Specific Instructions</b> on page 2.)	
	Check appropriate box: <input type="checkbox"/> Individual/Sole proprietor <input type="checkbox"/> Corporation <input type="checkbox"/> Partnership <input type="checkbox"/> Other ▶	
	Address (number, street, and apt. or suite no.)	Requester's name and address (optional)
City, state, and ZIP code	List account number(s) here (optional)	
<b>Part I Taxpayer Identification Number (TIN)</b> Enter your TIN in the appropriate box. For individuals, this is your social security number (SSN). However, if you are a resident alien OR a sole proprietor, see the instructions on page 2. For other entities, it is your employer identification number (EIN). If you do not have a number, see <b>How To Get a TIN</b> on page 2. <b>Note:</b> If the account is in more than one name, see the chart on page 2 for guidelines on whose number to enter.		<b>Part II For Payees Exempt From Backup Withholding</b> (See the instructions on page 2.)
<b>Part III Certification</b> Under penalties of perjury, I certify that:		
1. The number shown on this form is my correct taxpayer identification number (or I am waiting for a number to be issued to me), <b>and</b> 2. I am not subject to backup withholding because: (a) I am exempt from backup withholding, or (b) I have not been notified by the Internal Revenue Service (IRS) that I am subject to backup withholding as a result of a failure to report all interest or dividends, or (c) the IRS has notified me that I am no longer subject to backup withholding.		
<b>Certification Instructions.</b> —You must cross out item 2 above if you have been notified by the IRS that you are currently subject to backup withholding because you have failed to report all interest and dividends on your tax return. For real estate transactions, item 2 does not apply. For mortgage interest paid, acquisition or abandonment of secured property, cancellation of debt, contributions to an individual retirement arrangement (IRA), and generally, payments other than interest and dividends, you are not required to sign the Certification, but you must provide your correct TIN. (See the instructions on page 2.)		
Sign Here	Signature ▶	Date ▶

Form W-2

After the calendar year is over, you must furnish copies of Form W-2, WAGE AND TAX STATEMENT, to each employee to whom you paid wages during the year. (See Exhibit 2.6.)

Form W-2 must show total wages and other compensation paid (even if not subject to withholding); total wages subject to social security and Medicare taxes; allocated tips (if any); amounts deducted for income, social security and Medicare taxes; and the total advance earned income credit payment. In all cases, you must give each of your employee the statement by January 31 following the end of the calendar year covered. If not computer generated, every effort should be made to ensure that Forms W-2 provided to employees are legible.

If employment ends before the close of the year, the employee may request the form earlier. You must give the employee a Form W-2 within 30 days of the employee's written request, if the 30-day period ends before January 31.

You should keep any undeliverable employee copies of Form W-2 (Copies B and C) as part of your records for 4 years.

EXHIBIT 2.6 - W-2

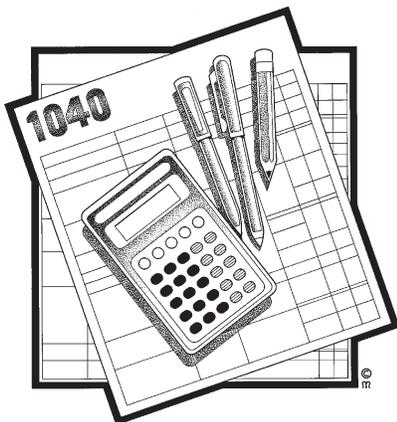
a Control number		22222	Void <input type="checkbox"/>	For Official Use Only ▶ OMB No. 1545-0008		
b Employer identification number		1 Wages, tips, other compensation		2 Federal income tax withheld		
c Employer's name, address, and ZIP code		3 Social security wages		4 Social security tax withheld		
		5 Medicare wages and tips		6 Medicare tax withheld		
		7 Social security tips		8 Allocated tips		
d Employee's social security number		9 Advance EIC payment		10 Dependent care benefits		
e Employee's name (first, middle initial, last)		11 Nonqualified plans		12 Benefits included in box 1		
		13 See instrs. for box 13		14 Other		
f Employee's address and ZIP code		15 Statutory employee <input type="checkbox"/>		Deceased <input type="checkbox"/>		
		Pension plan <input type="checkbox"/>		Legal rep. <input type="checkbox"/>		
		Deferred compensation <input type="checkbox"/>				
16 State	Employer's state I.D. no.	17 State wages, tips, etc.	18 State income tax	19 Locality name	20 Local wages, tips, etc.	21 Local income tax

**Form W-2 Wage and Tax Statement 1999**
Department of the Treasury—Internal Revenue Service  
For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

**Copy A For Social Security Administration**—Send this entire page with Form W-3 to the Social Security Administration; photocopies are **not** acceptable.
 Cat. No. 10134D

**Do NOT Cut, Staple, or Separate Forms on This Page — Do NOT Cut, Staple, or Separate Forms on This Page**

Income tax



The wages you pay your employees generally are subject to income tax withholding if their wages for any payroll period are more than the dollar amount of their withholding allowances for that period. The amount to be withheld is figured separately for each payroll period. Wages include all pay you give an employee for services performed. The pay may be in cash or in other forms. It includes salaries, vacation allowances, bonuses, commissions and fringe benefits not excluded by law. It does not matter how payments are measured or paid. Wages paid in any form other than money (such as goods, lodging and meals) are measured by the fair market value. See Publication 15, EMPLOYER'S TAX GUIDE (Circular E) for more information about income tax withholding.

## Tipped employees

Tips your employees receive are generally subject to withholding. Each month that your employees receive at least \$20 in tips, they must report to you all tips they receive. This report must be made by the 10th day of each month following the month in which the tips are received. Both tips that an employee receives directly from customers and tips that charge customers add to the bill and you pay to the employee must be reported. Your employee reports the tips on Form 4070, EMPLOYEE'S REPORT OF TIPS TO EMPLOYER. See Publication 1244, EMPLOYEE'S DAILY RECORD OF TIPS AND REPORT TO EMPLOYER, which includes Form 4070, for more information.

**Note:** *There are special tip reporting requirements for large food and beverage establishments. These businesses provide food and beverages for consumption on the premises, tipping is customary, and they usually employ more than 10 employees on a typical business day. These rules affect only the reporting requirements.*



## All employees

The income tax to be withheld is figured on gross wages before any deductions are made for social security and Medicare taxes, pension, union dues, insurance, etc. You may figure the withholding by any of several methods, the most common of which are the percentage method and the wage bracket tables method. Publication 15 contains the applicable tables and instructions for using both of these withholding methods, and it gives more information on reporting and withholding requirements on wages and tip income.

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## Social security and Medicare taxes

Under the Federal Insurance Contributions Act (FICA), you must withhold social security and Medicare taxes from wages that you pay your employees each payroll period.

Generally, meals, lodging, clothing, services, and other payments in kind are subject to social security and Medicare taxes, as are wages paid in cash. However, meals are not taxable wages if furnished for the employer's convenience and on the employer's premises. Lodging is not taxable if furnished for the employer's convenience, on the employer's premises, and as a condition of employment.

You, as an employer, must withhold and deposit the employee's part of the taxes and pay a matching amount. The social security tax is withheld from the employee's gross wages until the employee's cumulative wages for the year reach the wage based limit. Any wages above the wage based limit are not subject to social security tax withholding. However, there is no wage base limit for Medicare tax; **all covered wages are subject to Medicare tax.**

For 1999, the limit for wages subject to social security tax is \$72,600. The social security tax rate is 6.2% for the employee and 6.2% for the employer (12.4% total). The Medicare tax rate for the employee is 1.45% and 1.45% for the employer (2.9% total). This means that in 1999 you are to withhold employee social security and Medicare taxes at the total rate of 7.65% (6.2% up to \$72,600 plus 1.45% for all wages) and pay, or deposit, 15.30% (the total of the employee share and the employer's matching share of 7.65%).

## Federal Unemployment Tax

The Federal Unemployment Tax Act (FUTA) provides for the states and the Federal Government to cooperate in establishing and administering an unemployment tax program. Most employers pay both a federal and a state unemployment tax. The federal unemployment program was enacted to encourage the states to provide payment to workers who have lost their jobs. Only the employer pays FUTA tax; it is not deducted from an employee's wages.

For 1999, federal unemployment tax is figured on the first \$7,000 you pay to each employee during the year. See Publication 15 and the INSTRUCTIONS FOR FORM 940 for more information.

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## Successor employer

If you acquired all or substantially all of the property used in the business of another employer, you may, in figuring the wage limit for social security and federal unemployment tax purposes, include the wages that employer paid to the employees who continue to work for you.

## Earned Income Credit (EIC)

The EIC is a tax credit for certain workers whose earned income is below a certain level. Because it is a “credit,” the EIC is subtracted from the amount of tax owed. Even workers who have not filed a tax return in previous years, because their wages were below the minimum income-level requirements to file, may be able to get the credit - but only if they file a tax return. Therefore, you must notify each employee who worked for you at any time during the year, and from whom you did not withhold any income tax, about the EIC. You will meet the notification requirements by giving the employee either Notice 797, POSSIBLE FEDERAL REFUND DUE TO THE EARNED INCOME CREDIT (EIC); your own written statement as long as it has the exact wording of Notice 797; or the official IRS Form W-2, WAGE AND TAX STATEMENT, which contains a statement on the back of Copy C. Exception: You do not need to notify those employees who claimed exemption from withholding on Form W-4, EMPLOYEE’S WITHHOLDING ALLOWANCE CERTIFICATE.

An employee who expects to earn less than \$26,928 in 1999 and has a qualifying child can receive advance payments of up to 60% of their EIC with their pay. To claim the advance EIC, eligible employees should fill out a Form W-5, EARNED INCOME CREDIT ADVANCE PAYMENT CERTIFICATE and return it to you. (See Exhibit 2.7.) You use the advance EIC tables in Publication 15 each payroll period to figure the correct amount of advance payment to include in the employee’s pay. The advance payment comes out of the withheld income tax and employee and employer social security and Medicare taxes, thereby reducing your total tax liability.

EXHIBIT 2.7 - FORM W-5

# 1999 Form W-5



Department of the Treasury  
Internal Revenue Service

## Instructions

### Purpose

Use Form W-5 if you are eligible to get part of the EIC in advance with your pay and choose to do so. The amount you can get in advance generally depends on your wages. If you are married, the amount of your advance EIC payments also depends on whether your spouse has filed a Form W-5 with his or her employer. However, your employer cannot give you more than \$1,387 throughout 1999 with your pay.

If you do not choose to get advance payments, you can still claim the EIC on your 1999 tax return.

### What Is the EIC?

The EIC is a credit for certain workers. It reduces tax you owe. It may give you a refund even if you do not owe any tax. For 1999, the EIC can be as much as \$2,312 if you have one qualifying child or \$3,816 if you have more than one qualifying child. If you do not have a qualifying child, you may still be eligible for a credit of up to \$347, but you **cannot** receive advance EIC payments. See **Who Is a Qualifying Child?** on page 2.

### Who Is Eligible To Get Advance EIC Payments?

You are eligible to get advance EIC payments if **all three** of the following apply.

1. You have at least one qualifying child.
2. You expect that your 1999 earned income and modified AGI (adjusted gross income) will each be less than \$26,928. Include your spouse's income if you plan to file a joint return. As used on this form, earned

income does not include amounts inmates in penal institutions are paid for their work or workfare payments (defined below). For most people, **modified AGI** is the same as adjusted gross income. But see the 1998 revision of **Pub. 596**, Earned Income Credit, for information about how to figure your 1999 modified AGI if you expect to receive tax-exempt interest; nontaxable payments from a pension, annuity, or an IRA; or you plan to file a 1999 Form 1040.

3. You expect to be able to claim the EIC for 1999. To find out if you may be able to claim the EIC, answer the questions on page 2.

**Workfare payments.** These are cash payments certain families receive from a state or local agency that administers public assistance programs funded under the Federal Temporary Assistance for Needy Families program in return for (1) work experience activities (including work associated with remodeling or repairing publicly assisted housing) if sufficient private sector employment is not available, or (2) community service program activities.

### How To Get Advance EIC Payments

If you are eligible to get advance EIC payments, fill in the 1999 Form W-5 at the bottom of this page. Then, detach it and give it to your employer. If you get advance payments, you **must** file a 1999 Federal income tax return.

You may have only **one** Form W-5 in effect at one time. If you and your spouse are both employed, you should file separate Forms W-5.

(Continued on page 2)

▼ Give the lower part to your employer; keep the top part for your records. ▼  
..... Detach here .....

Form <b>W-5</b>	<b>Earned Income Credit Advance Payment Certificate</b>	OMB No. 1545-1342
Department of the Treasury Internal Revenue Service	► Use the current year's certificate only. ► Give this certificate to your employer. ► This certificate expires on December 31, 1999.	<b>1999</b>
Type or print your full name		Your social security number

**Note:** If you get advance payments of the earned income credit for 1999, you **must** file a 1999 Federal income tax return. To get advance payments, you **must** have a qualifying child and your filing status must be any status **except** married filing a separate return.

	Yes	No
1 I expect to be able to claim the earned income credit for 1999, I do not have another Form W-5 in effect with any other current employer, and I choose to get advance EIC payments	<input type="checkbox"/>	<input type="checkbox"/>
2 Do you have a qualifying child?	<input type="checkbox"/>	<input type="checkbox"/>
3 Are you married?	<input type="checkbox"/>	<input type="checkbox"/>
4 If you are married, does your spouse have a Form W-5 in effect for 1999 with any employer?	<input type="checkbox"/>	<input type="checkbox"/>

Under penalties of perjury, I declare that the information I have furnished above is, to the best of my knowledge, true, correct, and complete.

Signature ►

Date ►

Advance EIC is not compensation for service rendered nor is it subject to payroll taxes. It does not change the amount of income tax or social security and Medicare taxes that you withhold from employees' wages. Advance EIC payments are treated as though the employer had paid the amounts to the IRS as tax deposits and are shown on the employment tax return as deposits. **You do not use your own funds to make these payments.**

<b>Reminder</b>
Do not continue advance EIC payments to an employee on wages of \$26,928 or more in 1999.

For more information, see Publication 15.

**Note:** *In 1999, an employee's advance EIC payments are limited to a total of \$1,387, although they may be entitled to more (the maximum credit can be as much \$2,312). They will have to claim any additional amount of EIC on their tax return.*

## Forms W-3 and 1096

Each year, you must file Form W-3, TRANSMITTAL OF WAGE AND TAX STATEMENTS, in order to transmit Copy A of Forms W-2 to the Social Security Administration by the last day of February after the calendar year for which the Forms W-2 are prepared. The Social Security Administration will process these forms and provide the IRS with the income tax data that it needs from those forms. The mailing address for the forms is on the W-3.

**Note:** *The totals on the Form W-3 you file each year should equal the totals from all Forms 941 filed for the year.*

Form 1096 is used to transmit Forms 1099, 1098, 5498 and W-2G to the Internal Revenue Service. You should file Form 1096 with Forms 1099 by the last day of February.

In completing all transmittal documents (Forms W-3 and 1096) and information returns, you must use the same taxpayer identification number regardless of whether you file transmittals from more than one location. (See Exhibits 2.8 and 2.9.)



EXHIBIT 2.8 - FORM W-3

**DO NOT STAPLE**

<b>a</b> Control number		33333		<b>For Official Use Only</b> ▶ OMB No. 1545-0008	
<b>b</b> <b>Kind of Payer</b> ▶	941	Military	943	<b>1</b> Wages, tips, other compensation	<b>2</b> Federal income tax withheld
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<b>3</b> Social security wages	<b>4</b> Social security tax withheld
	CT-1	Hshld. emp.	Medicare gov. emp.		
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<b>5</b> Medicare wages and tips	<b>6</b> Medicare tax withheld
<b>c</b> Total number of Forms W-2	<b>d</b> Establishment number			<b>7</b> Social security tips	<b>8</b> Allocated tips
<b>e</b> Employer identification number				<b>9</b> Advance EIC payments	<b>10</b> Dependent care benefits
<b>f</b> Employer's name				<b>11</b> Nonqualified plans	<b>12</b> Deferred compensation
<b>g</b> Employer's address and ZIP code				<b>13</b>	
				<b>14</b>	
<b>h</b> Other EIN used this year				<b>15</b> Income tax withheld by third-party payer	
<b>i</b> Employer's state I.D. no.					
Contact person	Telephone number		Fax number		E-mail address
	( )		( )		

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

Signature ▶ \_\_\_\_\_ Title ▶ \_\_\_\_\_ Date ▶ \_\_\_\_\_

Form **W-3** Transmittal of Wage and Tax Statements **1999** Department of the Treasury  
Internal Revenue Service

Send this entire page with the entire Copy A page of Forms W-2 to the Social Security Administration. Photocopies are **NOT** acceptable. Do not send any remittance (cash, checks, money orders, etc.) with FORMS W-2 and W-3.

**Changes To Note**

**"YOUR COPY" eliminated.** Form W-3 no longer contains a second "YOUR COPY" of the form. Be sure to make a copy of the completed form for your records.

**Separate instructions.** See the separate **Instructions for Forms W-2 and W-3** for information on completing this form.

**Purpose of Form**

Use this form to transmit Copy A of Forms W-2. Make a copy of Form W-3, and keep it with Copy D (For Employer) of Forms W-2 for your records. Use Form W-3 for the correct year. **File Form W-3 even if only one Form W-2 is being filed.** If you are filing Forms W-2 on magnetic media or electronically, **do not** file Form W-3.

**When To File**

File Form W-3 with Copy A of Forms W-2 by February 29, 2000.

**Where To File**

Send this entire page with the entire Copy A page of Forms W-2 to:

**Social Security Administration  
Data Operations Center  
Wilkes-Barre, PA 18769-0001**

**Note:** If you use "Certified Mail" to file, change the ZIP code to "18769-0002." If you use an IRS approved private delivery service, add "ATTN: W-2 PROCESS, 1150 E. Mountain Dr." to the address and change the ZIP code to "18702-7997." See Circular E (Pub. 15) for a list of IRS approved private delivery services.

For Privacy Act and Paperwork Reduction Act Notice, see the 1999 Instructions for Forms W-2 and W-3.

EXHIBIT 2.9 - FORM 1096

DO NOT STAPLE 6969

Form <b>1096</b> Department of the Treasury Internal Revenue Service	<b>Annual Summary and Transmittal of U.S. Information Returns</b>	OMB No. 1545-0108  <span style="font-size: 2em; font-weight: bold;">1999</span>
<div style="display: flex; justify-content: space-between;"> <div style="writing-mode: vertical-rl; transform: rotate(180deg); font-weight: bold; font-size: 0.8em;">ATTACH IRS LABEL HERE</div> <div style="flex-grow: 1;"> <p>FILER'S name</p> <hr/> <p>Street address (including room or suite number)</p> <hr/> <p>City, state, and ZIP code</p> </div> </div>		
If you are not using a preprinted label, enter in box 1 or 2 below the identification number you used as the filer on the information returns being transmitted. Do not fill in both boxes 1 and 2.		Name of person to contact if the IRS needs more information  Telephone number ( )
<b>For Official Use Only</b> <div style="border: 2px solid black; width: 100px; height: 20px; margin: 0 auto;"></div>		
1 Employer identification number	2 Social security number	3 Total number of forms
4 Federal income tax withheld \$		5 Total amount reported with this Form 1096 \$
Enter an "X" in only one box below to indicate the type of form being filed.		
W-2G 32	1098 81	1098-E 84
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1098-T 83	1099-A 80	1099-B 79
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-C 85	1099-DIV 91	1099-G 86
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-INT 92	1099-LTC 93	1099-MISC 95
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
1099-MSA 94	1099-OID 96	
<input type="checkbox"/>	<input type="checkbox"/>	
1099-PATR 97	1099-R 98	1099-S 75
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5498 28	5498-MSA 27	
<input type="checkbox"/>	<input type="checkbox"/>	

Please return this entire page to the Internal Revenue Service. Photocopies are NOT acceptable.

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Under penalties of perjury, I declare that I have examined this return and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

Signature ▶
Title ▶
Date ▶

### Instructions

**Purpose of form.** Use this form to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. (See *Where To File on the back*.) DO NOT USE FORM 1096 TO TRANSMIT MAGNETIC MEDIA. See **Form 4804**, Transmittal of Information Returns Reported Magnetically/Electronically.

**Use of preprinted label.** If you received a preprinted label from the IRS with Package 1099, place the label in the name and address area of this form inside the brackets. Make any necessary changes to your name and address on the label. However, do not use the label if the taxpayer identification number (TIN) shown is incorrect. **Do not prepare your own label. Use only the IRS-prepared label that came with your Package 1099.**

If you are not using a preprinted label, enter the filer's name, address (including room, suite, or other unit number), and TIN in the spaces provided on the form.

**Filer.** The name, address, and TIN of the filer on this form must be the same as those you enter in the upper left area of Form 1099, 1098, 5498, or W-2G. A filer includes a payer, a recipient of mortgage interest payments (including points) or student loan interest, an educational institution, a broker, a barter exchange, a creditor, a person reporting real estate transactions, a trustee or issuer of any individual retirement arrangement or a medical savings account (MSA) (including a Medicare+Choice MSA), and a lender who acquires an interest in secured property or who has reason to know that the property has been abandoned.

**Transmitting to the IRS.** Send the forms in a flat mailing (not folded). Group the forms by form number and transmit each group with a **separate** Form 1096. For example, if you must file both Forms 1098 and 1099-A, complete one Form 1096 to transmit your Forms 1098 and another Form 1096 to transmit your Forms 1099-A. You need not submit original and corrected returns separately. **Do not** send a form (1099, 5498, etc.) containing summary (subtotal) information with Form 1096. Summary information for the group of forms being sent is entered only in boxes 3, 4, and 5 of Form 1096.

**Box 1 or 2.** Complete only if you are not using a preprinted IRS label. Individuals not in a trade or business must enter their social security number in box 2; sole proprietors and all others must enter their employer identification number in box 1. However, sole proprietors who do not have an employer identification number must enter their social security number in box 2.

**Box 3.** Enter the number of forms you are transmitting with this Form 1096. Do not include blank or voided forms or the Form 1096 in your total. Enter the number of correctly completed forms, not the number of pages, being transmitted. For example, if you send one page of three-to-a-page Forms 5498 with a Form 1096 and you have correctly completed two Forms 5498 on that page, enter "2" in box 3 of Form 1096.

**Box 4.** Enter the total Federal income tax withheld shown on the forms being transmitted with this Form 1096.

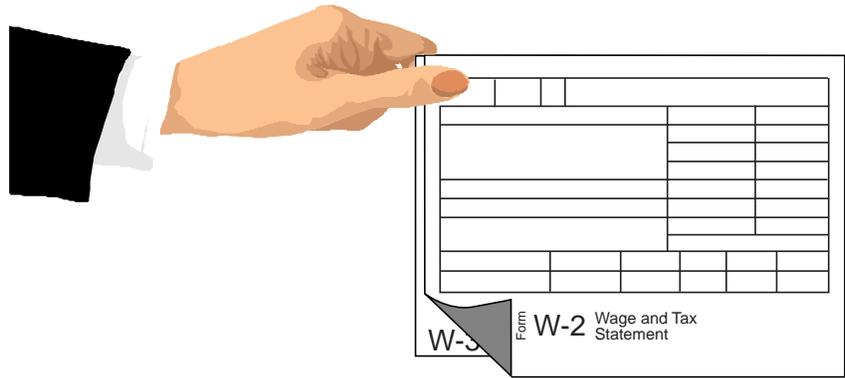
For more information and the Privacy Act and Paperwork Reduction Act Notice, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.

Cat. No. 144000

Form **1096** (1999)

## Correcting Forms W-2 and W-3

If there is an error on Forms W-2 or W-3, correct by filing Form W-2c, CORRECTED WAGE AND TAX STATEMENT and Form W-3c, TRANSMITTAL OF CORRECTED OF CORRECTED WAGE AND TAX STATEMENTS.



## Filing on magnetic media or electronically

Generally, the Social Security Administration will accept magnetic media or electronic records of Copy A of Forms W-2 or W-3 with prior approval. See the separate INSTRUCTIONS FOR FORM W-2 or W-3 for details about required magnetic media filing. If you file 250 or more Forms W-2, W-3 or 1099, you must file them on magnetic media or electronically.

## Information reporting call site

The IRS operates a centralized call site to answer questions about reporting on Forms W-2, W-3, 1099 and other information returns. If you have questions related to reporting on information returns, call (304) 263-8700 (not toll-free).



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## Penalties

The following is a list of nine penalties that may be assessed for not complying with certain filing and payment requirements:

1. Failure to file.
2. Failure to pay.
3. Dishonored check.
4. Failure to timely file an information return with IRS or SSA.
5. Failure to timely furnish a copy of any information return to the payee.
6. Failure to file a partnership return.
7. Failure to make Federal Tax Deposits on time in an authorized government depository.
8. Failure to furnish specific information on an information return, such as including taxpayer identification numbers.
9. Failure to collect and/or pay over Trust Fund taxes (Trust Fund Recovery Penalty).

## Putting it all together

In this lesson you:

- briefly studied employment taxes;
- reviewed the Employer Identification Number (EIN);
- learned the definitions of “employee” and “independent contractor” for tax purposes;
- learned about Forms W-4, I-9 and information Forms 1099-Misc, W-9 and W-2;
- were introduced to the following subjects:
  - federal income tax (withheld from employees);
  - social security and Medicare taxes (withheld from employees and paid by employers) and federal unemployment taxes;
  - successor employer; and
  - Earned Income Credit
- learned about Forms W-3 and 1096 and how to correct errors on Forms W-2 and W-3;
- read about transmitting Forms W-2 and 1099 on magnetic media or electronically; and
- learned about nine penalties that may be assessed for not complying with certain filing and payment requirements.

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## Exercises

Do the following exercises to put it all together:

### Exercise 1

Bill Bean started a dry cleaning business and hired two employees. What form does he use to get an employer identification number? *(Form)* \_\_\_\_\_

### Exercise 2

What form will your employee complete and give to you for you to determine how much income tax to withhold? *(Form)* \_\_\_\_\_

### Exercise 3

- (A) What are the social security tax and Medicare tax rates on an employee's salary in 1999?
- (1) Social security tax rate \_\_\_\_\_%
- (2) Medicare tax rate \_\_\_\_\_%
- (B) What is the employer's share? \_\_\_\_\_
- (C) What is the 1999 wage base limit for social security? \$\_\_\_\_\_
- (D) What is the limit for Medicare? \_\_\_\_\_

### Exercise 4

- (A) What form will you give to each employee to show wages paid, social security, Medicare and income taxes withheld? \_\_\_\_\_
- (B) When is it due to the employee? *(Date)* \_\_\_\_\_

### Exercise 5

What form will you give an unincorporated independent contractor to whom you paid \$600 or more for services in the course of your trade or business? *(Form)* \_\_\_\_\_

### Exercise 6

If you make payments to an unincorporated independent contractor who does not give you his or her identifying number, at what rate will you withhold taxes on the payments? \_\_\_\_\_%

### Exercise 7

Mary Smith, your employee, wants advance payments of earned income credit added to her wages. What form should she complete and give to you? *(Form)* \_\_\_\_\_

### Exercise 8

What forms will you use to correct a Form W-2 that is in error? *(Form)* \_\_\_\_\_ and *(Form)* \_\_\_\_\_

*(Answers found on page A-1.)*

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**LESSON 3**

## Part I: Form 941, Employer's Quarterly Federal Tax Return

### Introduction

If you are an employer who is required to withhold income or social security and Medicare taxes, you must file a return reporting the amounts withheld. Form 941, EMPLOYER'S QUARTERLY FEDERAL TAX RETURN, usually is used for this purpose. However, other forms are used in certain circumstances. (Exhibit 3.1.)

Form 945, ANNUAL RETURN OF WITHHELD FEDERAL INCOME TAX, is used to report income tax withheld from non-payroll payments, such as pensions, IRAs, Gambling winnings and Back-up withholding.

If you are a sole proprietor and file Form 941 for business employees, you may include household employees on the form. Also, if you operate a farm for profit and file Form 943, EMPLOYER'S ANNUAL TAX RETURN FOR AGRICULTURAL EMPLOYEES, for your agricultural employees, you may include farm household workers on that form.

Publication 15, EMPLOYER'S TAX GUIDE (Circular E), explains the rules and methods for withholding, paying, depositing, and reporting federal income tax, social security and Medicare taxes, and federal unemployment (FUTA) tax on wages, tips, fringe benefits, and sick pay paid by third-party payers. It also explains who is an employee, what are taxable wages, and what are taxable tips.

Publication 15-A, EMPLOYER'S SUPPLEMENTAL TAX GUIDE, gives examples of employer-employee relationships and also explains the proper treatment of employee tips, bonuses, awards and wages not paid in money, such as meals, lodging and employer-provided services.

**Objectives**

At the end of this lesson, you will be able to:

1. Determine Form 941 deposit requirements.
2. Prepare a Form 941.

**References**

Publication 15, EMPLOYER'S TAX GUIDE (Circular E) and  
Publication 15-A, EMPLOYER'S SUPPLEMENTAL TAX GUIDE.

## Due dates for filing Form 941

Form 941 is due by the last day of the month after each quarter ends. The return filing dates are listed below:

Due Dates for Filing Form 941		
Quarter	Ends	Due Date
January, February, March	Mar. 31	Apr. 30*
April, May, June	June 30	July 31*
July, August, September	Sept. 30	Oct. 31*
October, November, December	Dec. 31	Jan. 31*
<i>*If the due date for a return falls on a Saturday, Sunday, or legal holiday, the due date is the next business day.</i>		

If you paid the quarterly tax payments in full, you are allowed an additional 10 days to file the return. For example, your return for the quarter that ends on March 31 would be due on May 10 instead of April 30.

Do not file more than one Form 941 per quarter and do not report more than one calendar quarter on a return.

If you receive a preaddressed Form 941 for a quarter in which you have no employees or may have temporarily stopped paying salaries, file a return anyway. This ensures that you will continue to receive Form 941 from the service center.

Seasonal employers are not required to file for quarters when they regularly have no tax liability because they have paid no wages. To alert the IRS that you will not have to file a return for one or more quarters during the year, check the seasonal employer box above line 1 on Form 941 each time you file. The IRS will mail two Forms 941 to you once a year after March 1. The preprinted name and address information will not include the date the quarter ended. You must enter that date when you file the return.

If you cease to do business or pay wages, you need to file a final return. The instructions for Form 941 give information on how to file if you sell, transfer, or merge your business with another business.

Always use the preaddressed form mailed to you, but if you do not receive a preaddressed form, fill in your name and address **exactly** as shown on the previous return. Printing or typing makes it easier to read and less subject to mistakes.

The date your quarter ends and your employer identification number (EIN) must also be shown. If you have not yet received notification of your EIN, write "Applied for" and the date you applied in the space provided for the EIN.

EXHIBIT 3.1 - FORM 941, EMPLOYER'S QUARTERLY FEDERAL TAX RETURN

**Form 941**  
(Rev. January 1999)  
Department of the Treasury  
Internal Revenue Service

**Employer's Quarterly Federal Tax Return**  
▶ See separate instructions for information on completing this return.  
Please type or print.

OMB No 1545-0029

Enter state code for state in which deposits were made ONLY if different from state in address to the right ▶ <input type="text"/>	Name (as distinguished from trade name) _____ Trade name, if any _____ Address (number and street) _____	Date quarter ended _____ Employer identification number _____ City, state, and ZIP code _____	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="text-align: center;">T</td></tr> <tr><td style="text-align: center;">FF</td></tr> <tr><td style="text-align: center;">FD</td></tr> <tr><td style="text-align: center;">FP</td></tr> <tr><td style="text-align: center;">I</td></tr> <tr><td style="text-align: center;">T</td></tr> </table>	T	FF	FD	FP	I	T
T									
FF									
FD									
FP									
I									
T									

If address is different from prior return, check here ▶

1	1	1	1	1	1	1	1	1	1	7	3	3	3	3	3	3	3	4	4	4	5	5	5
6	7	8	8	8	8	8	8	8	8	8	9	9	9	9	9	9	9	10	10	10	10	10	10

If you do not have to file returns in the future, check here ▶  and enter date final wages paid ▶ \_\_\_\_\_

If you are a seasonal employer, see **Seasonal employers** on page 1 of the instructions and check here ▶

1 Number of employees in the pay period that includes March 12th . . . ▶ 1	2	
2 Total wages and tips, plus other compensation . . . . .	3	
3 Total income tax withheld from wages, tips, and sick pay . . . . .	4	
4 Adjustment of withheld income tax for preceding quarters of calendar year . . . . .	5	
5 Adjusted total of income tax withheld (line 3 as adjusted by line 4—see instructions) . . . . .	6a	
6 Taxable social security wages . . . . .	6b	
6 Taxable social security tips . . . . .	6c	
7 Taxable Medicare wages and tips . . . . .	7a	
8 Total social security and Medicare taxes (add lines 6b, 6d, and 7b). Check here if wages are not subject to social security and/or Medicare tax . . . . . ▶ <input type="checkbox"/>	8	
9 Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ _____ ± Fractions of Cents \$ _____ ± Other \$ _____ =	9	
10 Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9—see instructions) . . . . .	10	
11 Total taxes (add lines 5 and 10) . . . . .	11	
12 Advance earned income credit (EIC) payments made to employees . . . . .	12	
13 Net taxes (subtract line 12 from line 11). If \$1,000 or more, this must equal line 17, column (d) below (or line D of Schedule B (Form 941)) . . . . .	13	
14 Total deposits for quarter, including overpayment applied from a prior quarter . . . . .	14	
15 Balance due (subtract line 14 from line 13). See instructions . . . . .	15	

16 Overpayment. If line 14 is more than line 13, enter excess here ▶ \$ \_\_\_\_\_ and check if to be:  Applied to next return OR  Refunded.

- All filers: If line 13 is less than \$1,000, you need not complete line 17 or Schedule B (Form 941).
- Semiweekly schedule depositors: Complete Schedule B (Form 941) and check here . . . . . ▶
- Monthly schedule depositors: Complete line 17, columns (a) through (d), and check here . . . . . ▶

17 Monthly Summary of Federal Tax Liability. Do not complete if you were a semiweekly schedule depositor.			
(a) First month liability	(b) Second month liability	(c) Third month liability	(d) Total liability for quarter

**Sign Here** Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature ▶ \_\_\_\_\_ Print Your Name and Title ▶ \_\_\_\_\_ Date ▶ \_\_\_\_\_

For Privacy Act and Paperwork Reduction Act Notice, see back of form. Cat. No. 17001Z Form 941 (Rev. 1-99)

3 - 4

## Form 941

Complete the state code boxes if you made your deposits in a state other than that shown in your address on Form 941. Enter the state code for the state where you made deposits in the box provided in the upper left corner of the form. Enter code "MU" in the box if you deposit in more than one state. **If you deposit in the same state as shown in your address, do not make an entry.**

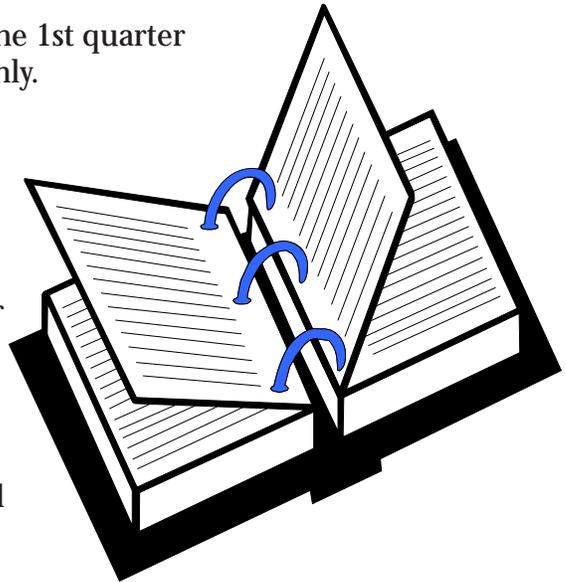
Complete lines 1 through 17, if applicable. Specific Form 941 line entries are discussed below. More complete information on these line entries is contained in the instructions for Form 941.

**Line 1.**

Make an entry for the 1st quarter (January–March) only.

**Line 2.**

Enter the total of: all wages paid, tips reported, taxable fringe benefits provided, and other compensation paid to your employees, even if you do not have to withhold income tax or social security tax on it. Do not include contributions to employee plans that are excluded from the employee's wages (e.g., section 401(k) and 125 plans).



**Line 3.**

Enter the income tax you withheld on wages, tips, taxable fringe benefits, and certain other payments.

**Line 6a.**

Taxable social security wages. Enter the total wages subject to social security taxes that you paid your employee during the quarter. Also include any sick pay and taxable fringe benefits subject to social security taxes. Stop reporting when an employee's wages (including tips) reach the wage base (\$72,600 in 1999). See Publication 15 for employment tax rates and wage bases. Multiply by applicable percentage.

**Line 6c.**

Taxable social security tips. Enter all tips your employees reported during the quarter, until tips and wages for an employee reach the wage base amount (\$72,600 in 1999). Do this even if you were not able to withhold the employee social security tax. See the Form 941 instructions for details on how to adjust the tax.

**Line 7a.**

Taxable Medicare wages and tips. Report all wages and tips, including any sick pay and taxable fringe benefits subject to Medicare tax. There is no limit on the amount of wages subject to Medicare.

**Line 8.**

Total social security and Medicare taxes. Remember to check the box if none of the wages are subject to social security or Medicare taxes.

**Line 9.**

Adjustment of social security and Medicare taxes. Fractions of cent adjustments need to be calculated. It is the small difference between net taxes (line 13) and total deposits (line 14), that may have been caused, all or in part, by rounding to the nearest cent each time you computed payroll. This rounding occurs when you figure the amount of social security and Medicare taxes to be withheld from each employee's wages.

To determine if you have a fractions-of-cents adjustment, multiply the total wages and tips for the quarter by the applicable percentage and compare these amounts with the total social security and Medicare taxes actually withheld from your payroll records. The difference, positive or negative, is your fractions-of-cents adjustment. See Publication 15 for instructions on other adjustments.

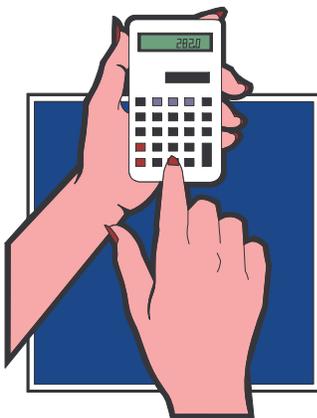
**Line 12.**

Enter any advance EIC payments made to employees.

**Line 13.**

Net taxes. Make sure the line equals line 17, column (d) below (or line D of Schedule B (Form 941)).

**Note:** *If you are either a semiweekly or monthly schedule depositor be sure to check the appropriate box below Line 16..*



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## Filing by other methods

### 941 TeleFile



You may be able to file Form 941 by phone if you receive TeleFile materials with your Form 941 package and qualify for this method.

Electronic and magnetic tape filing Reporting agents filing Forms 941 for groups of taxpayers can file them electronically or on tape. See Publication 15-A for details.

Now that you have covered the background information, you will study how deposits are made, how information is entered on the form, and how the tax due is figured.

### Tax liability

You incur your tax liability when you pay your wages, not when the payroll period ends. If your total taxes for the quarter are \$1,000 or more, you must complete the **RECORD OF FEDERAL TAX LIABILITY** on Form 941.

Tax liability is income tax withheld plus both the employee and employer shares of social security and Medicare taxes, minus any advance earned income credit (EIC) payments.



## Depositing requirements

In general, you must deposit income tax withheld and both the employer and employee social security and Medicare taxes (minus any advance EIC payments) by mailing or delivering a check, money order, or cash to an authorized financial institution or Federal Reserve bank. However, some taxpayers are required to deposit by electronic funds transfer (EFTPS).

## Payment with return

You may make a payment with Form 941 instead of depositing it if you accumulate less than a \$1,000 tax liability (reduced by any advance earned income credit) during the quarter (line 13 of Form 941). See Publication 15 for exceptions.

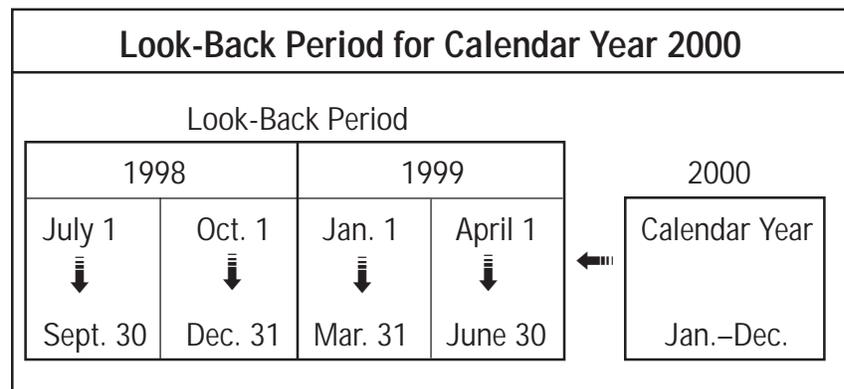
## When to deposit

There are two deposit schedules - **monthly or semiweekly** - for determining when you deposit social security, Medicare, and withheld income taxes. These schedules tell you when a deposit is due after a tax liability arises (e.g., when you have a payday).

## Look-Back period

Your deposit schedule for a calendar year is determined from the total taxes (not reduced by any advance EIC payments) reported on your Forms 941 (line 11) in a four-quarter look-back period. The look-back period begins July 1 and ends June 30 (Exhibit 3.2). If you reported \$50,000 or less of taxes for the look-back period, you are a monthly schedule depositor; if you reported more than \$50,000 you are a semiweekly schedule depositor.

EXHIBIT 3.2 – LOOK-BACK PERIOD FOR CALENDAR YEAR 2000



**Monthly deposit schedule**

Under the monthly deposit schedule, deposit Form 941 taxes on payments made during a month by the 15<sup>th</sup> day of the following month.

**Note to new employers:**

***During the first calendar year of your business, your tax liability for each quarter, in the look-back period, is considered to be zero. Therefore, you are a monthly schedule depositor for the first calendar year of your business.***

**Semiweekly deposit schedule**

You are a semiweekly schedule depositor for a calendar year if the total taxes on Form 941 (line 11) during your look-back period were more than \$50,000. For payrolls made on Wednesday, Thursday, and /or Friday, you must deposit the Form 941 taxes no later than the following Wednesday. For payrolls made on Saturday, Sunday, Monday and/or Tuesday, deposit by Friday.

**EXHIBIT 3.3 – SEMIWEEKLY DEPOSIT SCHEDULE**

Semiweekly Deposit Schedule	
IF the day falls on a...	THEN deposit taxes by the following...
Wednesday, Thursday and/or Friday	Wednesday
Saturday, Sunday, Monday and/or Tuesday	Friday

**Application of monthly and semiweekly schedule**

The terms “monthly schedule depositor” and “semiweekly schedules depositor” do not refer to how often your business pays its employees or even how often you are required to make deposits. These terms identify a set of deposit rules you must follow when employment tax liability occurs and are based on the date wages are paid.

## \$100,000 next-day deposit rule

If you accumulate a tax liability (reduced by any advance EIC payments) of \$100,000 or more on any day during a deposit period, you must deposit the tax by the next banking day, even if you are a monthly or semiweekly schedule depositor. If you are a monthly depositor and become subject to the rule you become a semiweekly depositor for the remainder of the year and all of the following year.

## How to deposit

The two methods of depositing employment taxes are by the Electronic Federal Tax Payment System (EFTPS) and Federal Tax Deposit (FTD) coupons (Form 8109).

You are required to make electronic deposits using EFTPS of all your tax liabilities in 2000 if your total deposits of **all** federal depository taxes were more than \$200,000 in 1998. For more details, see Publication 15.

Even if you are not required to make electronic tax deposits, you may voluntarily participate in EFTPS. To enroll call 1-800-945-8400 or 1-800-555-4477.



**Note: No penalties for failing to deposit electronically, if required to do so, will be assessed before January 1, 2000.**

If you are not required to use EFTPS then you should make your required deposits by FTD coupons to an authorized financial institution or Federal Reserve bank (FRB) using Form 8109 (see Exhibit 3.4). The IRS will issue you a book of coupons 5 to 6 weeks after you receive your EIN.

No matter how your deposits are made, make sure they are made timely. Check with your local depository or FRB for information concerning their cutoff time (exact hour they start their next banking day).



EXHIBIT 3.5 – FORM 941, EMPLOYER'S QUARTERLY FEDERAL TAX RETURN

**Form 941**  
(Rev. January 1999)  
Department of the Treasury  
Internal Revenue Service

**Employer's Quarterly Federal Tax Return**  
▶ See separate instructions for information on completing this return.  
Please type or print.

OMB No. 1545-0029

T
FF
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I
T

Enter state code for state in which deposits were made ONLY if different from state in address to the right (see page 2 of instructions) 11

Name (as distinguished from trade name) **SMITH ENTERPRISES, INC.** Date quarter ended **3-31-1999**

Trade name, if any \_\_\_\_\_ Employer identification number **10-1614316**

Address (number and street) **1512 POPLAR ST.** City, state, and ZIP code **INN, MI 48200**

If address is different from prior return, check here

1	1	1	1	1	1	1	1	1	1	2	3	3	3	3	3	3	3	3	4	4	4	5	5	5
6											9				10			10			10			

If you do not have to file returns in the future, check here  and enter date final wages paid ▶ \_\_\_\_\_

If you are a seasonal employer, see Seasonal employers on page 1 of the instructions and check here ▶ \_\_\_\_\_

1 Number of employees in the pay period that includes March 12th ▶ 1	3	
2 Total wages and tips, plus other compensation . . . . .	6,850	00
3 Total income tax withheld from wages, tips, and sick pay . . . . .	573	00
4 Adjustment of withheld income tax for preceding quarters of calendar year . . . . .		
5 Adjusted total of income tax withheld (line 3 as adjusted by line 4—see instructions) . . . . .	573	00
6 Taxable social security wages . . . . .	6,850	00
6a $\times 12.4\% (.124) =$		849
6b Taxable social security tips . . . . .		40
6c $\times 12.4\% (.124) =$		
7 Taxable Medicare wages and tips . . . . .	6,850	00
7a $\times 2.9\% (.029) =$		198
7b		65
8 Total social security and Medicare taxes (add lines 6b, 6d, and 7b). Check here if wages are not subject to social security and/or Medicare tax. <input type="checkbox"/>	1,048	05
9 Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ _____ $\pm$ Fractions of Cents \$ <u>603</u> $\pm$ Other \$ _____ =		(03)
10 Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9—see instructions) . . . . .	1,048	02
11 Total taxes (add lines 5 and 10) . . . . .	1,621	02
12 Advance earned income credit (EIC) payments made to employees . . . . .		
13 Net taxes (subtract line 12 from line 11). If \$1,000 or more, this must equal line 17, column (d) below (or line D of Schedule B (Form 941)) . . . . .	1,621	02
14 Total deposits for quarter, including overpayment applied from a prior quarter. . . . .	1,621	02
15 Balance due (subtract line 14 from line 13). See instructions . . . . .		
16 Overpayment. If line 14 is more than line 13, enter excess here ▶ \$ _____ and check if to be: <input type="checkbox"/> Applied to next return OR <input type="checkbox"/> Refunded.		

- All filers: If line 13 is less than \$1,000, you need not complete line 17 or Schedule B (Form 941).
- Semiweekly schedule depositors: Complete Schedule B (Form 941) and check here
- Monthly schedule depositors: Complete line 17, columns (a) through (d), and check here

17 Monthly Summary of Federal Tax Liability. Do not complete if you were a semiweekly schedule depositor.			
(a) First month liability	(b) Second month liability	(c) Third month liability	(d) Total liability for quarter
567.20	562.54	491.28	1,621.02

**Sign Here** Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature ▶ Helen Smith Print Your Name and Title ▶ HELEN SMITH, SECY Date ▶ 4/28/99

For Privacy Act and Paperwork Reduction Act Notice, see back of form. Cat. No. 17001Z Form 941 (Rev. 1-99)

## Deposit penalties

Deposit not made in a timely manner may be subject to penalties. For amounts not properly or timely deposited, the penalty rates are:

- **2%** - Deposits made 1 to 5 days late.
- **5%** - Deposits made 6 to 10 days late.
- **10%** - Deposits made 16 or more days late.
- **10%** - Deposits made at an unauthorized financial institution, paid directly to the IRS, or paid with your tax return. See Publication 15 for exceptions.
- **10%** - Amounts that are subject to electronic deposit requirements but not deposited using EFTPS.
- **15%** - Amounts still unpaid more than 10 days after the date of the first notice the IRS sent asking for the tax due or the day on which you receive notice and demand for immediate payment, whichever is earlier.

## Correcting Form 941

Errors made in figuring taxes in an earlier quarter can be corrected on a current Form 941 by making an adjustment to the current quarter's taxes. The instructions for Form 941 describe in detail how to correct errors to income tax withholding, social security and Medicare taxes.

**Note:** *There are special rules for correcting income tax withholding errors. Form 941c, SUPPORTING STATEMENT TO CORRECT INFORMATION, is required to substantiate the adjustment. See the instructions for Forms 941 and 941c.*

## Summary

In this lesson, you studied:

- Form 941 and its due dates,
- deposit requirements,
- the method of depositing taxes due and
- some of the sections and lines of Form 941.



Remember: Form 941 is a quarterly return, but deposits may be required more often.

## Exercises

### Exercise 1

Green for Ever, Inc.  
 EIN: 10-1234567  
 925 Fern Ave.  
 Augusta, GA 32599

Biweekly Pay Period Ending	Number of Employees	Gross Wages	Social Security Tax Withheld	Medicare Tax Withheld	Income Tax Withheld
4/9/99	2	\$2,050	\$127.10	\$29.73	\$163.00
4/23/99	3	3,805	235.91	55.17	285.00
5/7/99	4	5,545	343.79	80.40	356.00
5/21/99	4	5,975	370.45	86.64	373.00
6/4/99	4	5,050	313.10	73.23	328.00
6/18/99	3	4,405	273.11	63.87	467.00
Totals		\$26,830	\$1,663.46	\$389.04	\$1,972.00

First, figure the amount and date of deposits (the company is a monthly depositor). Then complete a Form 941 (Exhibit 3.6) using the information provided.

Deposit dates and amounts are:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Total deposit \$ \_\_\_\_\_

*(Answers are found on pages A-2 and A-3.)*



---

**Exercise 2**

In May, you decide to employ your 16 year-old son to assist you in your yard service business, Glenn's Landscaping. You are advised to have him complete a Form W-4, which he does, showing no (0) withholding allowances and single filing status. It is agreed upon that he will earn \$5.00 per hour and be paid every two weeks. He had worked 36 hours when it came time to make out his first paycheck. Using Publication 15 as a reference, answer the following:

How much should you withhold from his check?

Social Security Tax            \$\_\_\_\_\_

Medicare Tax                    \$\_\_\_\_\_

Federal Income Tax            \$\_\_\_\_\_

*(Answers are found on page A-2.)*

**Exercise 3**

Paul's Auto Shop, Inc.  
 EIN 10-9876543  
 425 Auto Strip Dr.  
 Cando, LA 88877

Biweekly Pay Period Ending	Number of Employees	Gross Wages	Social Security Tax Withheld	Medicare Tax Withheld	Income Tax Withheld Before AEIC	AEIC Payments
10/1/99	20	\$30,025	\$1,861.55	\$435.36	\$5,980.00	\$45.00
10/15/99	20	29,826	1,849.12	432.48	5,726.00	36.00
10/29/99	18	27,500	1,705.00	398.75	5,335.00	28.00
11/12/99	18	28,845	1,788.39	418.25	5,576.00	14.00
11/26/99	20	26,214	1,625.27	380.10	5,433.00	20.00
12/10/99	20	30,025	1,861.55	435.36	5,980.00	45.00
12/24/99	20	30,025	1,861.55	435.36	5,980.00	45.00
12/30/99 (Bonus)	20	4,000	248.00	58.00	155.00	3.00
Totals		\$206,460	\$12,800.43	\$2,993.66	\$40,165.00	\$236.00

First, figure the amount and date of deposits (the corporation is a semiweekly depositor). Then complete a Form 941 (Exhibit 3.7), using the information provided.

Deposit dates and amounts are:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Total Deposit \$ \_\_\_\_\_

*(Answers are found on pages A-2 and A-4.)*

EXHIBIT 3.7 – BLANK FORM 941, EMPLOYER’S QUARTERLY FEDERAL TAX RETURN

**Form 941**  
(Rev. January 1999)  
Department of the Treasury  
Internal Revenue Service

**Employer’s Quarterly Federal Tax Return**  
▶ See separate instructions for information on completing this return.  
Please type or print.

OMB No 1545-0029

T
FF
FD
FP
I
T

Enter state code for state in which deposits were made ONLY if different from state in address to the right ▶  (see page 2 of instructions).

Name (as distinguished from trade name) \_\_\_\_\_ Date quarter ended \_\_\_\_\_

Trade name, if any \_\_\_\_\_ Employer identification number \_\_\_\_\_

Address (number and street) \_\_\_\_\_ City, state, and ZIP code \_\_\_\_\_

If address is different from prior return, check here ▶

**IRS USE**

1	1	1	1	1	1	1	1	1	1	2	3	3	3	3	3	3	3	3	4	4	4	5	5	5	
6	7	8	8	8	8	8	8	8	8	8	9	9	9	9	9	9	9	9	9	10	10	10	10	10	10

If you do not have to file returns in the future, check here ▶  and enter date final wages paid ▶ \_\_\_\_\_

If you are a seasonal employer, see **Seasonal employers** on page 1 of the instructions and check here ▶

**1** Number of employees in the pay period that includes March 12th . ▶  **1**

<b>2</b> Total wages and tips, plus other compensation . . . . .	<b>2</b>	
<b>3</b> Total income tax withheld from wages, tips, and sick pay . . . . .	<b>3</b>	
<b>4</b> Adjustment of withheld income tax for preceding quarters of calendar year . . . . .	<b>4</b>	
<b>5</b> Adjusted total of income tax withheld (line 3 as adjusted by line 4—see instructions) . . . . .	<b>5</b>	
<b>6</b> Taxable social security wages . . . . .	<b>6a</b>	× 12.4% (.124) = <b>6b</b>
Taxable social security tips . . . . .	<b>6c</b>	× 12.4% (.124) = <b>6d</b>
<b>7</b> Taxable Medicare wages and tips . . . . .	<b>7a</b>	× 2.9% (.029) = <b>7b</b>
<b>8</b> Total social security and Medicare taxes (add lines 6b, 6d, and 7b). Check here if wages are not subject to social security and/or Medicare tax . . . . . ▶ <input type="checkbox"/>	<b>8</b>	
<b>9</b> Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ _____ ± Fractions of Cents \$ _____ ± Other \$ _____ =	<b>9</b>	
<b>10</b> Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9—see instructions) . . . . .	<b>10</b>	
<b>11</b> Total taxes (add lines 5 and 10) . . . . .	<b>11</b>	
<b>12</b> Advance earned income credit (EIC) payments made to employees . . . . .	<b>12</b>	
<b>13</b> Net taxes (subtract line 12 from line 11). If \$1,000 or more, this must equal line 17, column (d) below (or line D of Schedule B (Form 941)) . . . . .	<b>13</b>	
<b>14</b> Total deposits for quarter, including overpayment applied from a prior quarter . . . . .	<b>14</b>	
<b>15</b> Balance due (subtract line 14 from line 13). See instructions . . . . .	<b>15</b>	

**16** Overpayment. If line 14 is more than line 13, enter excess here ▶ \$ \_\_\_\_\_ and check if to be:  Applied to next return OR  Refunded.

- All filers: If line 13 is less than \$1,000, you need not complete line 17 or Schedule B (Form 941).
- Semiweekly schedule depositors: Complete Schedule B (Form 941) and check here . . . . . ▶
- Monthly schedule depositors: Complete line 17, columns (a) through (d), and check here . . . . . ▶

**17 Monthly Summary of Federal Tax Liability.** Do not complete if you were a semiweekly schedule depositor.

(a) First month liability	(b) Second month liability	(c) Third month liability	(d) Total liability for quarter

**Sign Here** Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature ▶ \_\_\_\_\_ Print Your Name and Title ▶ \_\_\_\_\_ Date ▶ \_\_\_\_\_

For Privacy Act and Paperwork Reduction Act Notice, see back of form. Cat. No. 17001Z Form 941 (Rev. 1-99)

## LESSON 3

## Part II: Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return

### Introduction

The Federal Unemployment Tax Act (FUTA) provides for states and the federal government to cooperate in establishing and administering the unemployment tax program. The program provides for payments of unemployment compensation to workers who have lost their jobs.

The various states create the actual employment insurance systems. The federal government approves the state laws and pays the administrative costs of the state programs.

Under this dual system, the employer is first subject to a tax levied by the state. This tax then becomes a credit against a separate federal tax. You may be exempt from state tax but still have to pay the federal tax.

The federal unemployment (FUTA) tax is reported on Form 940, EMPLOYER'S ANNUAL FEDERAL UNEMPLOYMENT (FUTA) TAX RETURN or Form 940-EZ, EMPLOYER'S ANNUAL FEDERAL UNEMPLOYMENT (FUTA) TAX RETURN. Both forms cover one calendar year and are generally due January 31 of the following year. (Exhibits 3.8 and 3.9.)

### Objectives

At the end of this lesson, you will be able to:

1. Define employer, employee, and wages subject to FUTA.
2. Figure the FUTA tax due.
3. Figure the deposits for FUTA taxes.
4. Complete Form 940-EZ.

### References

Publication 15, EMPLOYER'S TAX GUIDE (Circular E) and Publication 15-A, EMPLOYER'S SUPPLEMENTAL TAX GUIDE.

## Who are employers?



In general, you are an employer for FUTA tax purposes and must file and pay FUTA tax if, during the current *or* preceding year, you:

- paid wages of \$1,500 or more in any calendar quarter to employees (other than farm workers or household workers), or
- had one or more employees (other than farm workers or household workers) at any time in each of any 20 weeks (calendar).

The 20 weeks do not have to be consecutive. Count all regular, temporary, and part-time employees, and count employees on vacation or sick leave.

You may be liable for the state unemployment tax and not liable for the FUTA tax. Conversely, you may be exempt from state tax and still have to pay the federal tax. The definition of employer under state laws may differ from the definition under federal law.

**Note:** *the term “employer” as used here refers to a person who is an employer for FUTA tax purposes only. It is possible not to be an employer for FUTA tax purposes and still be an employer for social security and Medicare tax purposes or for purposes of withholding income tax.*

## Who are employees?



The rules used for purposes of social security and Medicare tax also apply in determining who are common-law employees for purposes of FUTA tax.

For FUTA tax, as for social security and Medicare taxes, there are statutory employees and non-employees in addition to common-law employees.

Refer to the charts of special classes of employment in Publication 15 to see which employees are covered by, or are exempt from, FUTA tax.

## What are FUTA wages?

As with wages for income tax withholding and social security and Medicare tax purposes, FUTA tax wages generally include money and other forms of payment to employees. For other exceptions, refer to Publication 15 or Publication 15-A.

## Wages not paid in money

If you pay your employees in some medium that is neither cash nor a readily negotiable instrument (such as a check), you are said to pay them “in kind.” Payments in kind may be in the form of goods, lodging, food, clothing, or services. Generally, wages paid in kind are treated the same way as wages paid in money. The value of a wage payment in kind is its fair market price on the day the payment is made.

## Employee taxes paid by employer

Generally, if you pay an employee’s liability for social security and Medicare taxes without deducting the tax from the employee’s pay, you must include the amount of the payment in the employee’s wages for purposes of the FUTA tax.



## Figuring FUTA tax

The FUTA tax is figured on the first \$7,000 in wages paid to each employee during the year. The tax is imposed on you as the employer. You must **not** collect it or deduct it from the wages you pay your employees.

The current FUTA tax rate is 6.2%. Generally, you can take a credit against your FUTA tax for amounts you paid into state unemployment funds. This credit cannot be more than 5.4% of the taxable wages. If you are entitled to the maximum 5.4% credit, the FUTA tax rate after the credit is 0.8%.

## Example

In November 1998, you hired Alice Green, and paid her \$3,500 in wages before the year ended. All \$3,500 was subject to the FUTA tax. The first \$7,000 you pay her in 1999 is also subject to the tax. Alice’s total wages for 1999 reached \$7,000 in mid-March. None of the wages you pay her for the remainder of the year are subject to the tax.

In July, Alice quits her job, and you hire someone to replace her. The first \$7,000 you pay Alice’s replacement in 1999 is also subject to the tax.

## Credit for contributions to states

Contributions are payments that a state requires an employer to make to its unemployment fund for the payment of unemployment benefits. However, contributions do not include:

Any payments deducted or deductible from your employees' pay.

Penalties, interest, or special administrative taxes not included in the contribution rate the state assigned to you.

Voluntary contributions paid to get a lower assigned rate.

You may receive an additional credit if you have a state experience rate lower than 5.4% (.054). This applies even if your rate is different during the year. This additional credit is equal to the difference between actual payments and the amount you would have been required to pay at 5.4%.

The total credit allowable may not be more than 5.4% of the taxable FUTA wages.



**Note:** *Credit for state contributions you make after the due date for filing Form 940 may not be more than 90% of the amount that would have been allowable if you had paid the amounts by the due date.*

## State experience rate

Your state experience rate is the rate at which the state taxes your payroll for state unemployment purposes. This rate may be adjusted from time to time based on the number and length of claims for unemployment compensation that your former employees make against the fund. If you do not know your rate, contact your state employment security agency.

If you have been granted an experience rate lower than the maximum credit of 5.4% by a state for all or part of the year, you are still allowed the full credit. However, you cannot take credit for any state taxes that you are liable and do not pay.

## Successor employer

If you acquire substantially all the property used in the business (or a unit of the business) of a previous employer who was subject to this tax, you may count, for purposes of the \$7,000 annual limit, the wages the previous employer paid during the year to the employees who continue to work for you.

---

## Depositing the tax

If, at the end of any calendar quarter, you owe, but have not yet deposited, more than \$100 in FUTA tax, you must make a deposit by the last day of the next month if the accumulated tax at the end of any of the first three quarters is \$100 or less, do not deposit the amount; instead, add it to the tax for the next quarter.

To figure your tax for each quarter, multiply .8% (.008) by the part of the first \$7,000 of each employee's annual FUTA tax wages that you paid during the quarter.

## When to deposit

Deposit the FUTA tax by the last day of the first month after the quarter ends.

If your liability for the fourth quarter (plus any amount not deposited from any earlier quarter) is over \$100, deposit the entire amount by the due date (January 31) of Form 940 or Form 940-EZ. If it is \$100 or less, you can either make a deposit or pay the tax with your Form 940 or 940-EZ by January 31.

## How to deposit

If your FUTA tax liability for any calendar quarter in 1999 is over \$100 (including any FUTA tax carried forward from an earlier quarter), you must deposit the tax by electronic funds transfer (EFTPS) **or** in an authorized financial institution using Form 8109, FEDERAL TAX DEPOSIT COUPON.

## Example

Tim Tower has two employees. In each quarter of 1999, George is paid wages of \$3,000 and Mark is paid wages of \$2,000. Tim's FUTA tax liability for each of the first and second quarters is \$40 ( $\$5,000 \times .008$ ). He is not required to deposit after the first or second quarter because his liability at the end of the second quarter is \$80 (not more than \$100). During the third quarter, Tim paid wages of \$3,000 subject to FUTA tax. Only \$1,000 of George's wages is taxable because \$6,000 was paid in the first two quarters. All of Mark's wages are taxable because he has not reached the \$7,000 level. Tim's tax liability for the third quarter is \$24 ( $\$3,000 \times .008$ ). His liability through the third quarter is \$104 (\$40 for each of the first and second quarters plus \$24 for the third). He must deposit \$104 by November 1, 1999.

In the fourth quarter, none of George's wages are subject to FUTA but \$1,000 of Mark's is taxable. Tim should pay \$8. ( $\$1,000 \times .008$ ) with the Form 940 or 940-EZ.

EXHIBIT 3.8 – FORM 940, EMPLOYER’S ANNUAL FEDERAL UNEMPLOYMENT (FUTA) TAX RETURN, PAGE 1

<p><b>Form 940</b></p> <p>Department of the Treasury Internal Revenue Service (O)</p>	<p><b>Employer’s Annual Federal Unemployment (FUTA) Tax Return</b></p> <p>▶ See separate instructions for information on completing this return.</p>	<p>OMB No. 1545-0028</p> <p style="font-size: 2em; font-weight: bold;">1998</p> <table border="1" style="width:100%; border-collapse: collapse;"> <tr><td>T</td><td></td></tr> <tr><td>FF</td><td></td></tr> <tr><td>FD</td><td></td></tr> <tr><td>FP</td><td></td></tr> <tr><td>I</td><td></td></tr> <tr><td>T</td><td></td></tr> </table>	T		FF		FD		FP		I		T				
T																	
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<p>☐ Name (as distinguished from trade name) <span style="float: right;">Calendar year ☐</span></p> <p>Trade name, if any</p> <p>Address and ZIP code <span style="float: right;">Employer identification number</span></p>																	
<p><b>A</b> Are you required to pay unemployment contributions to only one state? (If “No,” skip questions B and C.) <span style="float: right;">☐ Yes ☐ No</span></p> <p><b>B</b> Did you pay all state unemployment contributions by February 1, 1999? ((1) If you deposited your total FUTA tax when due, check “Yes” if you paid all state unemployment contributions by February 10. (2) If a 0% experience rate is granted, check “Yes.” (3) If “No,” skip question C.) <span style="float: right;">☐ Yes ☐ No</span></p> <p><b>C</b> Were all wages that were taxable for FUTA tax also taxable for your state’s unemployment tax? <span style="float: right;">☐ Yes ☐ No</span></p> <p>If you answered “No” to any of these questions, you must file Form 940. If you answered “Yes” to all the questions, you may file Form 940-EZ, which is a simplified version of Form 940. (Successor employers see <b>Special credit for successor employers</b> on page 3 of the instructions.) You can get Form 940-EZ by calling 1-800-TAX-FORM (1-800-829-3676) or from the IRS’s Internet Web Site at <a href="http://www.irs.ustreas.gov">www.irs.ustreas.gov</a>.</p>																	
<p>If you will not have to file returns in the future, check here, and complete and sign the return . . . . . ▶ ☐</p> <p>If this is an Amended Return, check here . . . . . ▶ ☐</p>																	
<p><b>Part I Computation of Taxable Wages</b></p> <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:70%;">1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees . . . . .</td> <td style="width:10%; text-align: center;">1</td> <td style="width:20%;"></td> </tr> <tr> <td>2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ▶</td> <td style="text-align: center;">2</td> <td style="background-color: #cccccc;"></td> </tr> <tr> <td>3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. <b>Do not use your state wage limitation</b> . . . . .</td> <td style="text-align: center;">3</td> <td style="background-color: #cccccc;"></td> </tr> <tr> <td>4 Total exempt payments (add lines 2 and 3) . . . . . ▶</td> <td style="text-align: center;">4</td> <td></td> </tr> <tr> <td>5 <b>Total taxable wages</b> (subtract line 4 from line 1) . . . . . ▶</td> <td style="text-align: center;">5</td> <td></td> </tr> </table>			1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees . . . . .	1		2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ▶	2		3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. <b>Do not use your state wage limitation</b> . . . . .	3		4 Total exempt payments (add lines 2 and 3) . . . . . ▶	4		5 <b>Total taxable wages</b> (subtract line 4 from line 1) . . . . . ▶	5	
1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees . . . . .	1																
2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ▶	2																
3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. <b>Do not use your state wage limitation</b> . . . . .	3																
4 Total exempt payments (add lines 2 and 3) . . . . . ▶	4																
5 <b>Total taxable wages</b> (subtract line 4 from line 1) . . . . . ▶	5																
<p><b>Be sure to complete both sides of this return, and sign in the space provided on the back.</b></p> <p>For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. <span style="float: right;">Cat. No. 112340 <b>Form 940</b> (1998)</span></p> <p style="text-align: center; font-weight: bold;">DETACH HERE</p>																	
<p><b>Form 940-V</b></p> <p>Department of the Treasury Internal Revenue Service</p>	<p><b>Form 940 Payment Voucher</b></p> <p>Use this voucher only when making a payment with your return.</p>	<p>OMB No. 1545-0028</p> <p style="font-size: 2em; font-weight: bold;">1998</p>															
<p>Complete boxes 1, 2, 3, and 4. Do not send cash, and do not staple your payment to this voucher. Make your check or money order payable to the “United States Treasury”. Be sure to enter your employer identification number, “Form 940”, and “1998” on your payment.</p>																	
<p>1 Enter the amount of the payment you are making</p> <p>▶ \$</p>	<p>2 Enter the first four letters of your last name (business name if partnership or corporation)</p>	<p>3 Enter your employer identification number</p>															
<p><b>Instructions for Box 2</b></p> <p>—Individuals (sole proprietors, trusts, and estates)— Enter the first four letters of your last name.</p> <p>—Corporations and partnerships—Enter the first four characters of your business name (omit “The” if followed by more than one word).</p>																	
<p>4 Enter your business name (individual name for sole proprietors)</p> <p>Enter your address</p> <p>Enter your city, state, and ZIP code</p>																	

EXHIBIT 3.8 – FORM 940, EMPLOYER’S ANNUAL FEDERAL UNEMPLOYMENT (FUTA) TAX RETURN, PAGE 2

Form 940 (1998)										Page <b>2</b>	
<b>Part II Tax Due or Refund</b>											
<b>1</b> Gross FUTA tax. Multiply the wages in Part I, line 5, by .062 . . . . .										<b>1</b>	
<b>2</b> Maximum credit. Multiply the wages in Part I, line 5, by .054 . . . . .										<b>2</b>	
<b>3 Computation of tentative credit (Note: All taxpayers must complete the applicable columns.)</b>											
(a) Name of state	(b) State reporting number(s) as shown on employer's state contribution returns	(c) Taxable payroll (as defined in state act)	(d) State experience rate period		(e) State ex- perience rate	(f) Contributions if rate had been 5.4% (col. (c) x .054)	(g) Contributions payable at experience rate (col. (c) x col. (e))	(h) Additional credit (col. (f) minus col. (g)): if 0 or less, enter -0-	(i) Contributions paid to state by 940 due date		
			From	To							
<b>3a</b> Totals . . . . . ▶											
<b>3b</b> Total tentative credit (add line 3a, columns (h) and (i) only—for late payments also see the instructions for Part II, line 6 . . . . . ▶											
<b>6</b> Credit: Enter the smaller of the amount in Part II, line 2 or line 3b; or amount from the worksheet in the line 6 instructions . . . . .										<b>6</b>	
<b>7</b> Total FUTA tax (subtract line 6 from line 1). If the result is over \$100, also complete Part III . . . . .										<b>7</b>	
<b>8</b> Total FUTA tax deposited for the year, including any overpayment applied from a prior year . . . . .										<b>8</b>	
<b>9</b> Balance due (subtract line 8 from line 7). Pay to the "United States Treasury". If you owe more than \$100, see "Depositing FUTA Tax" on page 3 of the instructions . . . . . ▶										<b>9</b>	
<b>10</b> Overpayment (subtract line 7 from line 8). Check if it is to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded . . . . . ▶										<b>10</b>	
<b>Part III Record of Quarterly Federal Unemployment Tax Liability (Do not include state liability.) Complete only if line 7 is over \$100. See page 6 of the instructions.</b>											
Quarter		First (Jan. 1–Mar. 31)	Second (Apr. 1–June 30)	Third (July 1–Sept. 30)	Fourth (Oct. 1–Dec. 31)	Total for year					
Liability for quarter											
Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and, to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments to employees.											
Signature ▶				Title (Owner, etc.) ▶				Date ▶			
 Printed on recycled paper <span style="float: right;">* U.S.GPO: 1998-435-136</span>											

EXHIBIT 3.9 – FORM 940-EZ, EMPLOYER'S ANNUAL FEDERAL UNEMPLOYMENT (FUTA) TAX RETURN

Form **940-EZ**

Department of the Treasury  
Internal Revenue Service (99)

**Employer's Annual Federal  
Unemployment (FUTA) Tax Return**

► For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

OMB No. 1545-1110

**1998**

T	
FF	
FD	
FP	
I	
T	

Name (as distinguished from trade name) \_\_\_\_\_ Calendar year \_\_\_\_\_

Trade name, if any \_\_\_\_\_

Address and ZIP code \_\_\_\_\_ Employer identification number \_\_\_\_\_

*Answer the questions under Who May Use Form 940-EZ on page 2. If you cannot use Form 940-EZ, you must use Form 940 instead.*

**A** Enter the amount of contributions paid to your state unemployment fund. (See separate instructions.) . . . . . \$ \_\_\_\_\_

**B** (1) Enter the name of the state where you have to pay contributions . . . . . \_\_\_\_\_

(2) Enter your state reporting number as shown on your state unemployment tax return ► \_\_\_\_\_

If you will not have to file returns in the future, check here (see Who must file in separate instructions) and complete and sign the return. ►

If this is an Amended Return, check here . . . . . ►

**Part I Taxable Wages and FUTA Tax**

1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees . . . . .	1	
2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ► _____	2	
3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. Do not use your state wage limitation . . . . .	3	
4 Total exempt payments (add lines 2 and 3) . . . . .	4	
5 Total taxable wages (subtract line 4 from line 1) . . . . .	5	
6 FUTA tax. Multiply the wages on line 5 by .008 and enter here. (If the result is over \$100, also complete Part II.)	6	
7 Total FUTA tax deposited for the year, including any overpayment applied from a prior year . . . . .	7	
8 Balance due (subtract line 7 from line 6). Pay to the "United States Treasury" . . . . .	8	
9 Overpayment (subtract line 6 from line 7). Check if it is to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded ►	9	

**Part II Record of Quarterly Federal Unemployment Tax Liability** (Do not include state liability.) Complete only if line 6 is over \$100.

Quarter	First (Jan. 1 – Mar. 31)	Second (Apr. 1 – June 30)	Third (July 1 – Sept. 30)	Fourth (Oct. 1 – Dec. 31)	Total for year
Liability for quarter					

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and, to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments to employees

Signature ► \_\_\_\_\_ Title (Owner, etc.) ► \_\_\_\_\_ Date ► \_\_\_\_\_

See separate instructions for Form 940-EZ for information on completing this form. Cat. No. 10983G Form 940-EZ (1998)

DETACH HERE

---

Form **940-EZ(V)**

Department of the Treasury  
Internal Revenue Service

**Form 940-EZ Payment Voucher**

Use this voucher only when making a payment with your return.

OMB No. 1545-1110

**1998**

Complete boxes 1, 2, 3, and 4. Do not send cash, and do not staple your payment to this voucher. Make your check or money order payable to the "United States Treasury." Be sure to enter your employer identification number, "Form 940-EZ", and "1998" on your payment.

<p><b>1</b> Enter the amount of the payment you are making</p> <p>► \$ _____</p> <p><b>Instructions for Box 2</b></p> <p>—Individuals (sole proprietors, trusts, and estates)— Enter the first four letters of your last name.</p> <p>—Corporations and partnerships—Enter the first four characters of your business name (omit "The" if followed by more than one word).</p>	<p><b>2</b> Enter the first four letters of your last name (business name if partnership or corporation)</p> <p>_____</p> <p><b>3</b> Enter your employer identification number</p> <p>_____</p> <p><b>4</b> Enter your name (individual name for sole proprietors)</p> <p>Enter your address _____</p> <p>Enter your city, state, and ZIP code _____</p>
--	---

3-26

## Forms 940 and 940-EZ filing requirements

You can file Form 940-EZ instead of Form 940 if you :

- paid unemployment taxes (“contributions”) to only one state,
- paid all state unemployment taxes by February 1 (February 10 if you deposited all FUTA tax when due), and
- all wages that were taxable for FUTA tax purposes were also taxable for your state’s unemployment tax.

For example, if you paid wages to corporate officers (these wages are subject to FUTA tax) in a state that exempts these wages from its unemployment taxes, you cannot use Form 940-EZ.

## Form 940-EZ

### Lines A and B

You must complete lines A and B and Part I. If your FUTA tax (line 6) is over \$100, you must also complete Part II.

**Line A.**

Enter the amount of your state unemployment contributions. If you are lucky enough to have been given a state experience rate of 0% enter “0% rate” in the space.

**Line B(1).**

Enter the state where you pay unemployment contributions.

**Line B(2).**

Enter your state reporting number.

### Part I. Taxable Wages and FUTA Tax

**Line 1.**

Enter the total payments made during the year for services of employees.

**Line 2.**

Enter payments that are exempt for FUTA purposes, see Publication 15 (under Special Rules for Various Types of Services and Payments). Do not enter payments over \$7,000 for each employee.

**Line 3.**

Enter the amount of payments that were over the \$7,000 you paid each employee.

**Line 6.**

Compute the FUTA tax by multiplying the wages by .008.

**Line 7.**

Amount deposited.

**Line 8.**

Balance due.

**Line 9.**

Overpayment.

**Part II.  
Record of Quarterly  
FUTA Tax Liability**

Complete this part only if your FUTA tax on line 6 is over \$100. Your quarterly FUTA tax liability is figured by multiplying the wages subject to FUTA tax within the \$7,000 limit by .008. The total **must** match line 6 in part I.

Remember this is your tax liability based on when you paid wages not the amount or when deposits were made.

**Example of completed  
Form 940-EZ**

Sue Martin owner of Martin’s Fabric Shop has two employees, whom she paid each Friday. She meets all the filing requirements for Form 940-EZ. She made contributions of \$352.00 to the state of Virginia and her state unemployment number is VA94371. Form 940-EZ has been completed using the following information (Exhibit 3.10):

Martin’s Fabric Shop					
Employee	1 <sup>st</sup>	2 <sup>nd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>	Total
John	\$3,600	\$3,900	\$3,900	\$4,200	\$15,600
Mary	\$5,400	\$5,850	\$5,850	\$6,300	\$23,400

**Tips for completing  
Forms 940 or 940-EZ**

Always use a preaddressed form if available. This insures faster and more accurate processing. However, if your preaddressed form is not available, do not delay filing, because you could be charged a late filing penalty. Make certain you put exactly the same information on your blank form that was shown on your previous return; that is, name, address, ZIP code, and your employer identification number. If you have applied for an EIN, but have not received it, write “Applied for” and the date you applied in the space provided for the number (Exhibit 3.11.)

EXHIBIT 3.10 – FORM 940-EZ, SUE MARTIN EXAMPLE

Form <b>940-EZ</b> Department of the Treasury Internal Revenue Service (O)	<b>Employer's Annual Federal                  Unemployment (FUTA) Tax Return</b> ▶ For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.	OMB No. 1545-1110 <div style="border: 1px solid black; padding: 5px; font-size: 24pt; font-weight: bold;">1998</div> <table border="1" style="width:100%; border-collapse: collapse;"> <tr><td>T</td><td></td></tr> <tr><td>FF</td><td></td></tr> <tr><td>FD</td><td></td></tr> <tr><td>FP</td><td></td></tr> <tr><td>I</td><td></td></tr> <tr><td>T</td><td></td></tr> </table>	T		FF		FD		FP		I		T																									
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Name (as distinguished from trade name) <span style="float: right;">Calendar year</span> SUE MARTIN Trade name, if any MARTIN'S FABRIC SHOP Address and ZIP code 1070 MOUNTAIN ST. SOUTH FORT, VA 27711 Employer identification number 22-1122234																																						
Answer the questions under <b>Who May Use Form 940-EZ</b> on page 2. If you cannot use Form 940-EZ, you must use Form 940 instead. <b>A</b> Enter the amount of contributions paid to your state unemployment fund. (See separate instructions.) ▶ \$ 352.00 <b>B</b> (1) Enter the name of the state where you have to pay contributions ▶ VA (2) Enter your state reporting number as shown on your state unemployment tax return ▶ VA 94371 If you will not have to file returns in the future, check here (see Who must file in separate instructions) and complete and sign the return. ▶ <input type="checkbox"/> If this is an Amended Return, check here ▶ <input type="checkbox"/>																																						
<b>Part I Taxable Wages and FUTA Tax</b> <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:70%;">1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees</td> <td style="width:5%; text-align: center;">1</td> <td style="width:15%; text-align: right;">39,000</td> <td style="width:10%; text-align: right;">00</td> </tr> <tr> <td>2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ▶</td> <td style="text-align: center;">2</td> <td colspan="2" style="background-color: #cccccc;"></td> </tr> <tr> <td>3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. Do not use your state wage limitation.</td> <td style="text-align: center;">3</td> <td style="text-align: right;">25,000</td> <td style="text-align: right;">00</td> </tr> <tr> <td>4 Total exempt payments (add lines 2 and 3)</td> <td style="text-align: center;">4</td> <td style="text-align: right;">25,000</td> <td style="text-align: right;">00</td> </tr> <tr> <td>5 Total taxable wages (subtract line 4 from line 1)</td> <td style="text-align: center;">5</td> <td style="text-align: right;">14,000</td> <td style="text-align: right;">00</td> </tr> <tr> <td>6 FUTA tax. Multiply the wages on line 5 by .008 and enter here. (If the result is over \$100, also complete Part II.)</td> <td style="text-align: center;">6</td> <td style="text-align: right;">112</td> <td style="text-align: right;">00</td> </tr> <tr> <td>7 Total FUTA tax deposited for the year, including any overpayment applied from a prior year</td> <td style="text-align: center;">7</td> <td style="text-align: right;">112</td> <td style="text-align: right;">00</td> </tr> <tr> <td>8 Balance due (subtract line 7 from line 6). Pay to the "United States Treasury"</td> <td style="text-align: center;">8</td> <td></td> <td></td> </tr> <tr> <td>9 Overpayment (subtract line 6 from line 7). Check if it is to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded ▶</td> <td style="text-align: center;">9</td> <td></td> <td></td> </tr> </table>			1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees	1	39,000	00	2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ▶	2			3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. Do not use your state wage limitation.	3	25,000	00	4 Total exempt payments (add lines 2 and 3)	4	25,000	00	5 Total taxable wages (subtract line 4 from line 1)	5	14,000	00	6 FUTA tax. Multiply the wages on line 5 by .008 and enter here. (If the result is over \$100, also complete Part II.)	6	112	00	7 Total FUTA tax deposited for the year, including any overpayment applied from a prior year	7	112	00	8 Balance due (subtract line 7 from line 6). Pay to the "United States Treasury"	8			9 Overpayment (subtract line 6 from line 7). Check if it is to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded ▶	9		
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3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. Do not use your state wage limitation.	3	25,000	00																																			
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8 Balance due (subtract line 7 from line 6). Pay to the "United States Treasury"	8																																					
9 Overpayment (subtract line 6 from line 7). Check if it is to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded ▶	9																																					
<b>Part II Record of Quarterly Federal Unemployment Tax Liability</b> (Do not include state liability.) Complete only if line 6 is over \$100. <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <th style="width:15%;">Quarter</th> <th style="width:15%;">First (Jan. 1 – Mar. 31)</th> <th style="width:15%;">Second (Apr. 1 – June 30)</th> <th style="width:15%;">Third (July 1 – Sept. 30)</th> <th style="width:15%;">Fourth (Oct. 1 – Dec. 31)</th> <th style="width:15%;">Total for year</th> </tr> <tr> <td>Liability for quarter</td> <td style="text-align: right;">72.00</td> <td style="text-align: right;">40.00</td> <td></td> <td></td> <td style="text-align: right;">112.00</td> </tr> </table>			Quarter	First (Jan. 1 – Mar. 31)	Second (Apr. 1 – June 30)	Third (July 1 – Sept. 30)	Fourth (Oct. 1 – Dec. 31)	Total for year	Liability for quarter	72.00	40.00			112.00																								
Quarter	First (Jan. 1 – Mar. 31)	Second (Apr. 1 – June 30)	Third (July 1 – Sept. 30)	Fourth (Oct. 1 – Dec. 31)	Total for year																																	
Liability for quarter	72.00	40.00			112.00																																	
Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and, to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments to employees. Signature ▶ Sue Martin Title (Owner, etc.) ▶ owner Date ▶ 1/31/00 See separate Instructions for Form 940-EZ for information on completing this form. Cat. No. 10983G Form 940-EZ (1998)																																						
DETACH HERE																																						
Form <b>940-EZ(V)</b> Department of the Treasury Internal Revenue Service	<b>Form 940-EZ Payment Voucher</b> Use this voucher only when making a payment with your return.	OMB No. 1545-1110 <div style="border: 1px solid black; padding: 5px; font-size: 24pt; font-weight: bold;">1998</div>																																				
Complete boxes 1, 2, 3, and 4. Do not send cash, and do not staple your payment to this voucher. Make your check or money order payable to the "United States Treasury." Be sure to enter your employer identification number, "Form 940-EZ", and "1998" on your payment.																																						
1 Enter the amount of the payment you are making ▶ \$	2 Enter the first four letters of your last name (business name if partnership or corporation)	3 Enter your employer identification number																																				
Instructions for Box 2 —Individuals (sole proprietors, trusts, and estates)— Enter the first four letters of your last name. —Corporations and partnerships—Enter the first four characters of your business name (omit "The" if followed by more than one word).	4 Enter your name (individual name for sole proprietors) Enter your address Enter your city, state, and ZIP code																																					

EXHIBIT 3.11 – FORM 940

Form <b>940</b> Department of the Treasury Internal Revenue Service (O)	<b>Employer's Annual Federal                  Unemployment (FUTA) Tax Return</b> ▶ See separate instructions for information on completing this return.	OMB No. 1545-0028 <div style="text-align: center; font-size: 2em; font-weight: bold;">1998</div> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td>T</td><td></td></tr> <tr><td>FF</td><td></td></tr> <tr><td>FD</td><td></td></tr> <tr><td>FP</td><td></td></tr> <tr><td>I</td><td></td></tr> <tr><td>T</td><td></td></tr> </table>	T		FF		FD		FP		I		T	
T														
FF														
FD														
FP														
I														
T														
Name (as distinguished from trade name) _____ Calendar year _____ Trade name, if any _____ Address and ZIP code _____ Employer identification number _____														
<div style="font-size: 2em; font-weight: bold;">APPLIED FOR - (DATE)</div>														
<b>A</b> Are you required to pay unemployment contributions to only one state? (If "No," skip questions B and C.) . <input type="checkbox"/> Yes <input type="checkbox"/> No														
<b>B</b> Did you pay all state unemployment contributions by February 1, 1999? ((1) If you deposited your total FUTA tax when due, check "Yes" if you paid all state unemployment contributions by February 10. (2) If a 0%		_____												

## Summary

In this lesson you learned who must pay FUTA tax, what wages are subject to this tax, how to figure the amount of FUTA tax due, and when the tax must be deposited. You also learned how to complete Form 940-EZ. Important points to remember include:

- When Form 940 or 940-EZ is due;
- what the deposit requirements are; and
- only employers pay FUTA tax.

## Exercises

### Exercise 1

Mr. Wilson opened a business in January 1999 and hired six-employees. In the first quarter he paid the employees each week for 13 weeks. Use the following information to determine:

- (A) How much of the total wages is subject to FUTA tax? \$\_\_\_\_
- (B) What is the first quarter FUTA tax liability? \$\_\_\_\_\_
- (C) When is the deposit due date, if all state taxes have been made in a timely manner? (Date)\_\_\_\_\_

Mr. Wilson's Business	
Employee	Wages Paid in Quarter
R. Riding	\$ 4,500
M. Lamb	8,100
J. Nimble	3,400
C. Moon	5,600
C. Fiddle	4,900
P. Son	5,200
Total Wages	\$31,700

Assume that the same facts are true for the second quarter (that is, there are 13 paydays; each employee's wages remain the same; and no new employees are hired). Use the information in the previous table to determine:

- (D) How much of the total wages is subject to FUTA tax?  
\$\_\_\_\_\_
- (E) What is the second quarter FUTA tax liability? \$\_\_\_\_\_
- (F) Is a deposit due?     YES     NO
- (G) When an employer pays state contributions after the due date (or extended due date) of Form 940, the credit for the state contributions is \_\_\_\_% of the amount that would be allowed if the employer had paid the state contributions by the due date.

*(Answers are found on page A-5.)*

- (H) When state contributions have not been paid, how much credit is allowed? \_\_\_\_%

**Exercise 2**

Complete Form 940-EZ for ACME Inc., using Exhibit 3.11 - Blank Form 940-EZ on page 3-34 and the following information:

State reporting number: 12345

State taxable payroll: \$18,200

Experience rate: 2.7% from January 1 to December 31, 1998.

During 1998 and before the date of Form 940-EZ, ACME paid \$491.40 to Michigan for unemployment tax.

ACME, Inc.,  
EIN: 10-7654321  
123 First St.  
Cedar, MI 49621

ACME, Inc., Deposits					
Employee	Annual Wage	Quarter			
		1 <sup>st</sup>	2 <sup>nd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>
Ben Wood	\$12,600.00	\$3,150.00	\$2,850.00	\$1,000.00	-0-
Mary Birch	9,200.00	2,300.00	2,300.00	1,400.00	\$1,000.00
John Cane	4,200.00	1,050.00	1,050.00	1,050.00	1,050.00
Totals	26,000.00	6,500.00	6,200.00	3,450.00	2,050.00
x.008		\$52.00	49.60	27.60	16.40
Cumulative		\$52.00	101.60	27.60	44.00
Amount Deposited		-0-	101.60	-0-	-0-

A. When must ACME make deposit(s)? (Date) \_\_\_\_\_

B. How much must be deposited? \$ \_\_\_\_\_

C. How much must be paid with the return? \$ \_\_\_\_\_

*(Answers are found on pages A-5 and A-6.)*

EXHIBIT 3.12 - BLANK FORM 940-EZ

Form **940-EZ**

Department of the Treasury  
Internal Revenue Service (99)

**Employer's Annual Federal  
Unemployment (FUTA) Tax Return**

► For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.

OMB No. 1545-1110

**1998**

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Name (as distinguished from trade name) \_\_\_\_\_ Calendar year \_\_\_\_\_

Trade name, if any \_\_\_\_\_

Address and ZIP code \_\_\_\_\_ Employer identification number \_\_\_\_\_

*Answer the questions under Who May Use Form 940-EZ on page 2. If you cannot use Form 940-EZ, you must use Form 940 instead.*

**A** Enter the amount of contributions paid to your state unemployment fund. (See separate instructions.) . . . ► \$ \_\_\_\_\_

**B** (1) Enter the name of the state where you have to pay contributions . . . . . ► \_\_\_\_\_

(2) Enter your state reporting number as shown on your state unemployment tax return ► \_\_\_\_\_

If you will not have to file returns in the future, check here (see Who must file in separate instructions) and complete and sign the return. ►

If this is an Amended Return, check here . . . . . ►

**Part I Taxable Wages and FUTA Tax**

1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees . . . . .	1		
2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ► _____	2		
3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. Do not use your state wage limitation . . . . .	3		
4 Total exempt payments (add lines 2 and 3) . . . . .	4		
5 Total taxable wages (subtract line 4 from line 1) . . . . .	5		
6 FUTA tax. Multiply the wages on line 5 by .008 and enter here. (If the result is over \$100, also complete Part II.) . . . . .	6		
7 Total FUTA tax deposited for the year, including any overpayment applied from a prior year . . . . .	7		
8 Balance due (subtract line 7 from line 6). Pay to the "United States Treasury" . . . . .	8		
9 Overpayment (subtract line 6 from line 7). Check if it is to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded ►	9		

**Part II Record of Quarterly Federal Unemployment Tax Liability** (Do not include state liability.) Complete only if line 6 is over \$100.

Quarter	First (Jan. 1 - Mar. 31)	Second (Apr. 1 - June 30)	Third (July 1 - Sept. 30)	Fourth (Oct. 1 - Dec. 31)	Total for year
Liability for quarter					

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and, to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments to employees

Signature ► \_\_\_\_\_ Title (Owner, etc.) ► \_\_\_\_\_ Date ► \_\_\_\_\_

See separate Instructions for Form 940-EZ for information on completing this form. Cat. No. 10983G Form 940-EZ (1998)

**DETACH HERE**

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Form **940-EZ(V)**

Department of the Treasury  
Internal Revenue Service

**Form 940-EZ Payment Voucher**

Use this voucher only when making a payment with your return.

OMB No. 1545-1110

**1998**

Complete boxes 1, 2, 3, and 4. Do not send cash, and do not staple your payment to this voucher. Make your check or money order payable to the "United States Treasury." Be sure to enter your employer identification number, "Form 940-EZ", and "1998" on your payment.

1 Enter the amount of the payment you are making . . . . .	2 Enter the first four letters of your last name (business name if partnership or corporation)	3 Enter your employer identification number
► \$ _____	_____	_____
<p><b>Instructions for Box 2</b></p> <p>—Individuals (sole proprietors, trusts, and estates)— Enter the first four letters of your last name.</p> <p>—Corporations and partnerships—Enter the first four characters of your business name (omit "The" if followed by more than one word).</p>	4 Enter your name (individual name for sole proprietors)	
	Enter your address _____	
	Enter your city, state, and ZIP code _____	

3-33

## LESSON 4

## Business Use of Your Home



### Introduction

The purpose of this lesson is to provide information on figuring and claiming the deduction for business use of your home. The term **home** can include a house, apartment, condominium, mobile home, or boat. It also includes structures on the property, such as an unattached garage, studio, barn, or greenhouse.

### Objectives

1. Determine if you are eligible for the business use of the home deduction.
2. Complete the Form 8829, EXPENSES FOR THE BUSINESS USE OF YOUR HOME.

### Qualifying for a deduction

To deduct expenses related to the business use of part of your home, you must meet specific requirements. Even then, the deduction may be limited. To qualify to claim expenses for the business use of your home, you must meet the following tests:

- your use of the business part of your home must be:
  - exclusive (see Exceptions to Exclusive Use, later),
  - regular and
  - for your business, **and**
- the business part of your home must be one of the following:
  - your principal place of business,
  - a meeting place for customers in the transaction of your business, or
  - a separate structure (not attached to your home) you use in connection with your business.

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**Exclusive use**

To qualify under the exclusive use test, you must use a specific area of your home **only** for your trade or business. The area used for business can be a room or other separately identifiable space. The space does not need to be marked off by a permanent partition.

You do **not** meet the requirements of the exclusive use test if you use the area in question both for business and for personal purposes.

**Example:** You are an attorney and use a den in your home to write legal briefs and prepare client tax returns. Your family also uses the den for recreation. Since the den is not used exclusively in your profession, you **cannot** claim a business deduction for its use.

**Exceptions to exclusive use**

You do **not** have to meet the exclusive use test if:

- you use part of your home for the storage of inventory or product samples, or
- you use part of your home as a day-care facility.

**Regular use**

To qualify under the regular use test, you must use a specific area of your home for business on a continuing basis. You do not meet the test if your business use of the area is only occasional or incidental, even if you do not use that area for any other purpose.

**Principal place of business**

You can have more than one business location, including your home, for a single trade or business. One way to qualify to deduct the expenses for the business use of your home is if your home is your principal place of business. To determine this, you must consider all of the facts and circumstances.

Your home office will qualify as your principal place of business for deducting expenses for its use if:

- you use it exclusively and regularly for administrative or management activities of your trade or business, and
- you have no other fixed location where you conduct substantial administrative or management activities of your trade or business.

**Administrative or managerial activities**

The following activities that are administrative or managerial in nature:

- billing customers,
- keeping books and records,
- ordering supplies,
- setting up appointments and
- forwarding orders or writing reports.

The following activities will **not** disqualify your home office as your principal place of business:

- employing others to conduct your administrative or management activities at locations other than your home;
- conducting administrative or management activities at places that are not fixed locations of your business, such as in a car or a hotel room;
- conducting occasional, minimal administrative or management activities at a fixed location outside your home;
- conducting substantial non-administrative or non-management business activities at a fixed location outside your home; and
- having suitable space to conduct administrative or management activities outside your home, but choosing to use your home office for those activities instead.



**Example A:** Jon is a self-employed plumber. Most of Jon's time is spent at customers' homes and offices installing and repairing plumbing. He has a small office in his home that he uses exclusively and regularly for the administrative or management details of his business, such as phoning customers, ordering supplies, and keeping his books. Jon does not do his own billing. He uses a local bookkeeping service to bill his customers.

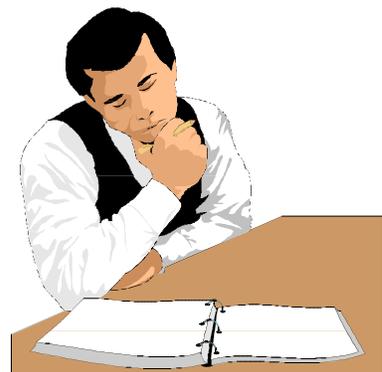
Jon's home office qualifies as his principal place of business for deducting expenses for its use. He uses the home office for the administrative or managerial activities of his plumbing business and he has no other fixed location where he conducts these administrative or managerial activities. His choice to have his billing done by another company does

not disqualify his home office as his principal place of business. Because he meets all of the qualifications, including principal place of business, he can deduct expenses (to the extent of the deduction limit) for the business use of his home.

**Example B:** Clyde is a self-employed anesthesiologist. He spends the majority of his time administering anesthesia and postoperative care in three local hospitals. One of the hospitals provides him with a small-shared office where he could conduct administrative or management activities. Clyde does not use the office the hospital provides. He uses a room in his home, that he has converted, as an office. He uses this room exclusively and regularly to conduct all the following activities:

- contacting patients, surgeons, and hospitals regarding scheduling;
- preparing for treatments and presentations;
- maintaining billing records and patient logs;
- satisfying continuing medical education requirements; and
- reading medical journals and books.

Clyde's home office qualifies as his principal place of business for deducting expenses for its use. He conducts administrative or management activities for his business as an anesthesiologist there and he has no other fixed location where he conducts administrative or management activities for this business. His choice to use his home office instead of one provided by the hospital does not disqualify his home office as his principal place of business. His performance of substantial nonadministrative or nonmanagement activities at fixed locations outside his home also does not disqualify his home office as his principal place of business. Because he meets all of the qualifications, including principal place of business, he can deduct expenses (to the extent of the deduction limit) for the business use of his home.



## Meeting place for customers

If you do not meet the principal place of business test, your home office may qualify if you meet or deal with customers in your home in the normal transaction of your business, even though you also carry on business at another location. You can deduct your expenses for the part of your home used exclusively and regularly for business if:

- you physically meet with customers at your home, and
- the use of your home is substantial and integral to the transaction of your business.

Using your home for occasional meetings and telephone calls will not qualify you to deduct expenses for the business use of your home.



## Separate structure

You can deduct expenses for a separate freestanding structure, such as a studio, garage, storage shed, or barn, if you use it exclusively and regularly for your business. The structure does not have to be your principal place of business or a place where you meet customers.

## Business percentage

Most expenses related to the business use of your home are limited to the percentage of your home used for business (business percentage).

To find the business percentage, compare the size of the part of your home that you use for business to your whole house. You can use any reasonable method to determine the business percentage. The following are two common methods you can use to figure the percentage.

### Area method

Divide the area used for business by the total area of your home.

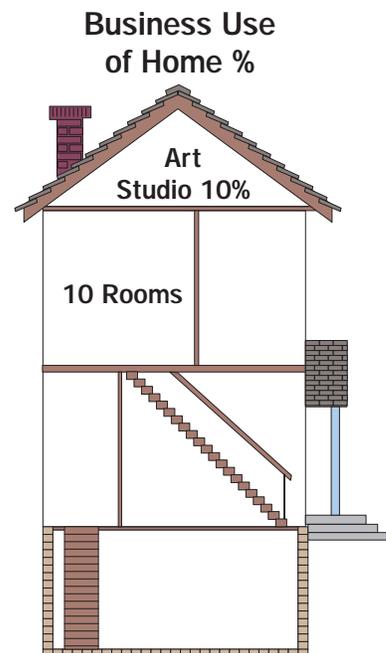
**Example:** Your office is 240 square feet. Your home is 1200 square feet. Your office is 20% (240/1200) of the total area of you home. Your business percentage is 20%.



### Number-of-rooms method

Divide the number of rooms used for business by the total number of rooms in your home. You can use this method if the rooms in your home are all about the same size.

**Example:** Peggy has an art studio in her home. She is allowed to take a deduction for the business use of her home. The rooms in her house are all about the same size. There are ten rooms and she uses one for a studio. Her business-use percentage is 10%. Peggy had utility bills of \$750 during the year. She can deduct \$75 (\$750 times 10%) as a business expense.



**Note:** Use lines 1-7 of Form 8829, EXPENSES FOR THE BUSINESS USE OF YOUR HOME, to figure your business percentage.

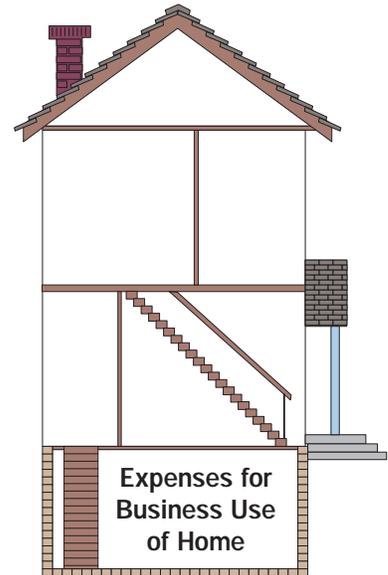
## Types of expenses

There are two types of expenses related to using your home for business.

1. Expenses related to the business activity in the home but not to the use of the home itself.
2. Expenses for the business use of the home.

Expenses for the business use of the home are divided into three categories.

1. Direct expenses
2. Indirect expenses
3. Unrelated expenses



## Expenses not related to business use of the home

Business expenses related to the business activity in the home but not to the use of the home itself are deductible in full on Schedule C (Form 1040) or Schedule F (Form 1040). These expenses are not limited to the business use of the home percentage or the deduction limit (discussed later). Examples of some of these expenses include the following:

- advertising,
- business taxes,
- car and truck expenses,
- salaries,
- supplies and
- travel.



**Expenses for business use of your home**

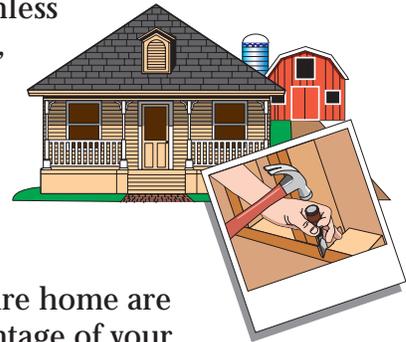
You must divide the expenses of operating your home between personal and business use. The part of a home operating expense that you can use to figure your deduction depends on:

- whether the expense is direct, indirect, or unrelated, and
- the percentage of your home that is used for business.

**Direct expenses**

Expenses only for the business part of your home are generally deductible in full unless subject to the deduction limit, discussed later.

**Example:** Painting or repairs only in the area used for business.



**Indirect expenses**

Expenses for running your entire home are deductible based on the percentage of your home used for business. They may also be subject to the deduction limit, discussed later.

**Examples:** Insurance, utilities, and general repairs.

**Unrelated expenses**

Expenses for the parts of your home not used for business are **not** deductible; (i.e. lawn care, painting a room not used for business).

**Example:** Jeff is allowed to take a deduction for the business use of his home. He has the following expenses:

Landscaping	\$1,500
Painting of the business office	700
Utilities for the entire house	1,060
Repairs to the roof of the house	500
Repairs to the business office	100
Painting of the bedroom	400

The painting of the bedroom and the landscaping are unrelated expenses. They cannot be deducted. The painting and repairs to the office are direct expenses and can be deducted in full. The repairs to the roof and utilities are indirect expenses. They are divided between business and personal parts of the house. The business part is deductible.

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## Examples of expenses

Certain expenses are deductible whether or not you use your home for business. However, if you qualify to claim business use of the home expenses, you can use the business part of these expenses to figure your business use of the home deduction. These expenses are:

- real estate taxes,
- deductible mortgage interest and
- casualty losses.

Other expenses are deductible only if you use your home for business. These expenses generally include (but are not limited to):

- insurance,
- rent,
- repairs,
- utilities and
- depreciation on your home.

***Examples of Expenses:*** Indirect expenses are divided into a business part and a personal part, using the business-use percentage.

**Real Estate Taxes:** To figure the business part of your real estate taxes, multiply the real estate taxes paid by the percentage of your home used for business.

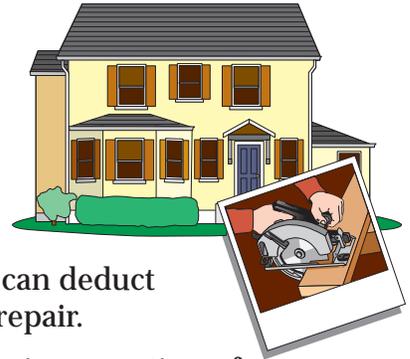
**Deductible Mortgage Interest:** To figure the business part of your deductible mortgage interest, multiply this interest by the percentage of your home used for business.

**Casualty Losses:** If you have a casualty loss on your home that you use for business, treat the casualty loss as a direct expense, an indirect expense, or an unrelated expense, depending on the property affected. If the loss is on a part of the property used for both business and personal purposes, use only the business portion to figure the deduction.

**Insurance:** You can deduct the cost of insurance that covers the business part of your home. However, if your insurance premium gives you coverage for a period that extends past the end of your tax year, you can deduct only the business percentage of the part of the premium that gives you coverage for your tax year.

**Rent:** If you rent, rather than own, a home and meet the requirements for business use of the home, you can deduct part of the rent you pay. To figure your deduction multiply your rent payments by the percentage of your home used for business.

**Repairs:** The cost of repairs and supplies that relate to your business, including labor, is a deductible expense. For example, a furnace repair benefits the entire home. If you use 10% of your home for business, you can deduct 10% of the cost of the furnace repair.



**Utilities:** You may deduct the business portion of your utility expenses. These expenses include gas, electricity, and water. Generally, the amount deductible is the business-use percentage multiplied by the utility expense.

The basic local telephone service charge, including taxes, for the first telephone line into your home is not deductible. However, charges for business long-distance phone calls on that line, as well as, the cost of a second line into your home used exclusively for business, are deductible business expenses. Deduct these charges on either Schedule C (Form 1040) or Schedule F (Form 1040). They are not part of your home office deduction.

**Depreciation:** Some expenses cannot be deducted all at once. The cost of any business property that lasts for more than one year must generally be deducted over a number of years. The annual expense is called depreciation. Depreciation reflects the reduction in value of the property.

To calculate depreciation on the business part of your home, you need to determine the depreciable basis of your home. Generally the depreciable basis of your home will be the lesser of:

1. the fair market value of your home (excluding land) on the date you first use it for business **or**
2. the purchase price (excluding land) plus any major improvements you made and minus any casualty losses or other changes to basis.

To determine how much of the depreciable basis you can use to compute your depreciation deduction, multiply the depreciable basis by the business-use percentage.

**Example:** Barry owns an accounting service. He uses 10% of his home as a business office. When Barry started his business, his home (exclusive of land) was worth \$60,000. The home cost \$50,000 and the land \$10,000. The depreciable basis of the home is \$50,000. Barry can claim depreciation of \$5,000 (\$50,000 depreciable basis multiplied by 10% business-use percentage).

For information on how to calculate depreciation, see IRS Publication 946, HOW TO DEPRECIATE PROPERTY.

**Example:** The following example shows how to compute business percentage of the various expenses using Form 8829, EXPENSES FOR THE BUSINESS USE OF YOUR HOME.

Renee has a private detective agency in her home. She is allowed to take a deduction for expenses related to the business use of the home. Renee's business-use percentage is 20 percent. She has the following expenses:

Real estate taxes	\$1000
Dues	50
Repairs to the floor of the office	200
Utilities	800
Transportation expenses	150
Insurance premiums on entire house	600
Mortgage Interest	700
Depreciation on entire house	700
Advertising	100
Painting the office	400
Business cards	50
Roof repair	100

Exhibit 4.1 shows lines 9-30, Form 8829, EXPENSES FOR THE BUSINESS USE OF YOUR HOME, for Renee. Dues, transportation, advertising, and business cards are expenses related to the business activity in the home but not to the business use of the home itself.

EXHIBIT 4.1 - EXPENSES RELATED TO THE BUSINESS USE OF THE HOME

Form <b>8829</b> Department of the Treasury Internal Revenue Service (O)	<b>Expenses for Business Use of Your Home</b> ▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year. ▶ See separate instructions.	OMB No. 1545-1266 <b>1998</b> Attachment Sequence No. 66 Your social security number 111 11 1122	
Name(s) of proprietor(s) <span style="font-size: 1.5em; font-family: cursive;">RENEE</span>			
<b>Part I Part of Your Home Used for Business</b>			
1	Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples. See instructions . . . . .	1	
2	Total area of home . . . . .	2	
3	Divide line 1 by line 2. Enter the result as a percentage . . . . .	3	%
• For day-care facilities not used exclusively for business, also complete lines 4-6. • All others, skip lines 4-6 and enter the amount from line 3 on line 7.			
4	Multiply days used for day care during year by hours used per day . . . . .	4	hr.
5	Total hours available for use during the year (365 days × 24 hours). See instructions . . . . .	5	8,760 hr.
6	Divide line 4 by line 5. Enter the result as a decimal amount . . . . .	6	
7	Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3 . . . . . ▶	7	20 %
<b>Part II Figure Your Allowable Deduction</b>			
8	Enter the amount from Schedule C, line 29, plus any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions. See instructions for columns (a) and (b) before completing lines 9-20.	8	
	(a) Direct expenses	(b) Indirect expenses	
9	Casualty losses. See instructions . . . . .		
10	Deductible mortgage interest. See instructions . . . . .	700 -	
11	Real estate taxes. See instructions . . . . .	1,000 -	
12	Add lines 9, 10, and 11. . . . .	1,700 -	
13	Multiply line 12, column (b) by line 7 . . . . .	13	
14	Add line 12, column (a) and line 13 . . . . .		340 -
15	Subtract line 14 from line 8. If zero or less, enter -0- . . . . .		
16	Excess mortgage interest. See instructions . . . . .		
17	Insurance . . . . .	600 -	
18	Repairs and maintenance . . . . .	100 -	
19	Utilities . . . . .	800 -	
20	Other expenses. See instructions . . . . .		
21	Add lines 16 through 20 . . . . .	1,500 -	
22	Multiply line 21, column (b) by line 7 . . . . .	300 -	
23	Carryover of operating expenses from 1997 Form 8829, line 41 . . . . .	23	
24	Add line 21 in column (a), line 22, and line 23 . . . . .		900 -
25	Allowable operating expenses. Enter the smaller of line 15 or line 24 . . . . .		
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15 . . . . .		
27	Excess casualty losses. See instructions . . . . .	27	
28	Depreciation of your home from Part III below . . . . .	140 -	
29	Carryover of excess casualty losses and depreciation from 1997 Form 8829, line 42 . . . . .	29	
30	Add lines 27 through 29 . . . . .		140 -
31	Allowable excess casualty losses and depreciation. Enter the smaller of line 26 or line 30 . . . . .		
32	Add lines 14, 25, and 31 . . . . .		
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to Form 4684, Section B . . . . .		
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions ▶		
<b>Part III Depreciation of Your Home</b>			
35	Enter the smaller of your home's adjusted basis or its fair market value. See instructions . . . . .	35	
36	Value of land included on line 35 . . . . .	36	
37	Basis of building. Subtract line 36 from line 35 . . . . .	37	
38	Business basis of building. Multiply line 37 by line 7 . . . . .	38	
39	Depreciation percentage. See instructions . . . . .	39	%
40	Depreciation allowable. Multiply line 38 by line 39. Enter here and on line 28 above. See instructions . . . . .	40	140 -
<b>Part IV Carryover of Unallowed Expenses to 1999</b>			
41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0- . . . . .	41	
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0- . . . . .	42	
For Paperwork Reduction Act Notice, see page 3 of separate instructions.			
Cat. No. 13232M		Form <b>8829</b> (1998)	
Printed on recycled paper		U.S.GPO:1998-435-552	

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## Deduction limit

If your gross income from the business use of your home equals or exceeds your total business expenses, you can deduct all your business expenses. If your gross income from that use is less than your total business expenses, your deduction for certain expenses for the business use of your home is limited.

Gross income is generally the total sales of your business less cost of goods sold.

To compute the deduction, and any limitation, you must:

- Determine the gross income from the business
- Identify all business expenses that do not relate to the business use of the home
- Identify the direct expenses related to the business use of the home
- Identify the indirect expenses related to the business use of the home
- Compute the business portion of indirect expenses

The general rule is that the deduction for the business use of the home for otherwise nondeductible expenses cannot be greater than your gross income limit.

Your gross income from business limit is figured as follows:

- Less the business-use percentage of deductible mortgage interest
- Less the business-use percentage of real estate taxes
- Less the business-use percentage of casualty losses
- Less business expenses that relate to the business activity in the home, but not to the use of the home itself.

The deduction limit only applies to otherwise nondeductible direct and indirect expenses including depreciation. When the deduction is limited, direct and other indirect expenses are deducted before depreciation.

**Example:** Gross income limit is \$500. The otherwise nondeductible expenses related to the business use of the home are \$800. The deduction for these expenses is limited to \$500.

## Carryforward

Expenses that cannot be deducted because of the gross income limitation can be carried forward to later years, subject to the gross income limit in those years.

**Example:** Computing the deduction and carryforward.

Renee has gross income of \$1,500.00 from her private detective agency. She has \$350 in business expenses that do not relate to the business use of the home. Her tentative profit is \$1,150 (\$1,500-\$350). Using figures from Exhibit 4.1, the business portion of her expenses are:

Mortgage interest	\$140
Real estate taxes	200
Direct expenses	600
Other indirect expenses	300
Depreciation	140

Renee can take a deduction of \$1,150 for expenses related to the business use of the home. The remaining \$230 (including all of the depreciation of \$140) is not deductible but can be carried forward. (See Exhibit 4.2.)



EXHIBIT 4.2 - EXPENSES NOT RELATED TO USE OF THE HOME

Form <b>8829</b> Department of the Treasury Internal Revenue Service (O)	<b>Expenses for Business Use of Your Home</b> ▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year. ▶ See separate instructions.	OMB No. 1545-1266 <b>1998</b> Attachment Sequence No. 66
Name(s) of proprietor(s) <u>RENEE</u>		Your social security number <u>111 11 1122</u>
<b>Part I Part of Your Home Used for Business</b>		
1 Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples. See instructions . . . . .	1	500
2 Total area of home . . . . .	2	3,500
3 Divide line 1 by line 2. Enter the result as a percentage . . . . .	3	20%
● For day-care facilities not used exclusively for business, also complete lines 4-6. ● All others, skip lines 4-6 and enter the amount from line 3 on line 7.		
4 Multiply days used for day care during year by hours used per day . . . . .	4	hr.
5 Total hours available for use during the year (365 days × 24 hours). See instructions . . . . .	5	8,760 hr.
6 Divide line 4 by line 5. Enter the result as a decimal amount . . . . .	6	
7 Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3 . . . . . ▶	7	20%
<b>Part II Figure Your Allowable Deduction</b>		
8 Enter the amount from Schedule C, line 29, plus any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions. See instructions for columns (a) and (b) before completing lines 9-20.	8	1,150 -
	(a) Direct expenses	(b) Indirect expenses
9 Casualty losses. See instructions . . . . .	9	
10 Deductible mortgage interest. See instructions . . . . .	10	700 -
11 Real estate taxes. See instructions . . . . .	11	1,000 -
12 Add lines 9, 10, and 11 . . . . .	12	1,700 -
13 Multiply line 12, column (b) by line 7 . . . . .	13	340
14 Add line 12, column (a) and line 13 . . . . .	14	340 -
15 Subtract line 14 from line 8. If zero or less, enter -0- . . . . .	15	810 -
16 Excess mortgage interest. See instructions . . . . .	16	
17 Insurance . . . . .	17	600 -
18 Repairs and maintenance . . . . .	18	600 -
19 Utilities . . . . .	19	100 -
20 Other expenses. See instructions . . . . .	20	800 -
21 Add lines 16 through 20 . . . . .	21	600 1,500 -
22 Multiply line 21, column (b) by line 7 . . . . .	22	300 -
23 Carryover of operating expenses from 1997 Form 8829, line 41 . . . . .	23	-
24 Add line 21 in column (a), line 22, and line 23 . . . . .	24	900 -
25 Allowable operating expenses. Enter the smaller of line 15 or line 24 . . . . .	25	810 -
26 Limit on excess casualty losses and depreciation. Subtract line 25 from line 15 . . . . .	26	-
27 Excess casualty losses. See instructions . . . . .	27	
28 Depreciation of your home from Part III below . . . . .	28	140 -
29 Carryover of excess casualty losses and depreciation from 1997 Form 8829, line 42 . . . . .	29	
30 Add lines 27 through 29 . . . . .	30	140 -
31 Allowable excess casualty losses and depreciation. Enter the smaller of line 26 or line 30 . . . . .	31	-
32 Add lines 14, 25, and 31 . . . . .	32	1,150 -
33 Casualty loss portion, if any, from lines 14 and 31. Carry amount to Form 4684, Section B . . . . .	33	-
34 Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions ▶	34	1,150 -
<b>Part III Depreciation of Your Home</b>		
35 Enter the smaller of your home's adjusted basis or its fair market value. See instructions . . . . .	35	
36 Value of land included on line 35 . . . . .	36	
37 Basis of building. Subtract line 36 from line 35 . . . . .	37	
38 Business basis of building. Multiply line 37 by line 7 . . . . .	38	
39 Depreciation percentage. See instructions . . . . .	39	%
40 Depreciation allowable. Multiply line 38 by line 39. Enter here and on line 28 above. See instructions . . . . .	40	140 -
<b>Part IV Carryover of Unallowed Expenses to 1999</b>		
41 Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0- . . . . .	41	90 -
42 Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0- . . . . .	42	140 -
For Paperwork Reduction Act Notice, see page 3 of separate instructions. <span style="float: right;">Cat. No. 13232M Form 8829 (1998)</span>		
Printed on recycled paper <span style="float: right;">* U.S.GPO: 1998-435-552</span>		

## Where to deduct expenses related to the business use of the home

Self-employed individuals show their business income and expenses on Schedule C (Form 1040), PROFIT OR LOSS FROM BUSINESS, or on Schedule F (Form 1040), PROFIT OR LOSS FROM FARMING. If you file Schedule C, expenses related to the business use of the home are figured on Form 8829, EXPENSES FOR THE BUSINESS USE OF YOUR HOME and the deductible amount carried over to line 30 of Schedule C. If you file Schedule F, figure your deduction using the worksheet at the end of Publication 587, BUSINESS USE OF YOUR HOME and show the deductible amount on line 34 of Schedule F. Write “*Business Use of Home*” on the dotted line beside the entry.

**Note:** Employees must itemize deductions on Schedule A (Form 1040) in order to claim the deduction for business use of their home. See Publication 587 for more information.

**Caution:** Do not take a double deduction for real estate taxes and mortgage interest. If you report an amount for the business portion of the taxes and interest on Schedule C (or Schedule F), make sure you report only the personal portion on Schedule A, ITEMIZED DEDUCTIONS. The amounts reported on Schedule C (or F) and Schedule A should be the total interest and taxes you paid for the year.



## Sale or exchange of your home

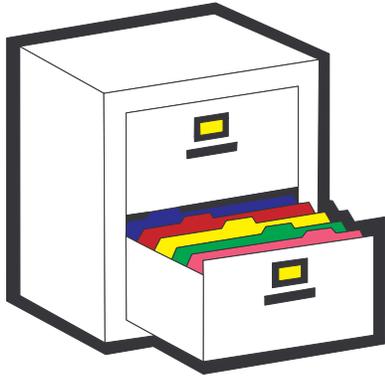
If you sold your home after May 6, 1997, you may be able to exclude up to \$250,000 (500,000 for certain married persons filing a joint return) of the capital gain on the sale. However, you cannot exclude any part of your gain that is equal to any depreciation allowed or allowable for the business use of your home after May 6, 1997. For more information on the sale or exchange of a home, get Publication 523, SELLING YOUR HOME.



## Depreciation

If you used any part of your home for business, you must adjust the basis of your home for any depreciation that was allowable for its business use, even if you did not claim it.

## Recordkeeping



You must keep records that provide the information needed to figure your deductions for the business use of your home. You should keep all canceled checks, receipts, invoices and other evidence of expenses you paid.

Your records must show the following information:

- The part of your home you use for business.
- That you use the part of the home exclusively and regularly for business and is one of the following:
  - your principal place of business, **or**
  - a place where you meet customers to transact your business, **or**
  - a separate structure.
- The depreciation and expenses for the business part of your home.

## Exercise

In 1999, Frank started a tax preparation business in his home. He meets the qualifications to deduct business use of his home. His house is 2,800 square feet and his office space is 280 square feet. He has the following expenses:

Mortgage interest	\$10,000
Advertising	200
Real estate taxes	2,500
Home owners insurance	500
Office supplies	600
Utilities	2,200
Paint (for office only)	200
General repairs (for home)	2,000

The fair market value of the house, which is less than the cost is \$250,000, and the value of the land is \$40,000. The depreciation percentage is 2.641. His tentative profit on Schedule C is \$30,000.

Compute the business use of home deduction for Frank using Form 8829, EXPENSES FOR THE BUSINESS USE OF YOUR HOME (EXHIBIT 4.3).

*(Answer on page A-7, Exhibit 4.4 - Filled-in Form 8829.)*

EXHIBIT 4.3 - BLANK FORM 8829

Form <b>8829</b> Department of the Treasury Internal Revenue Service (99)	<b>Expenses for Business Use of Your Home</b> ▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year. ▶ See separate instructions.	OMB No. 1545-1266 <b>1998</b> Attachment Sequence No. 66
Name(s) of proprietor(s)		Your social security number
<b>Part I Part of Your Home Used for Business</b>		
1	Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples. See instructions . . . . .	1
2	Total area of home . . . . .	2
3	Divide line 1 by line 2. Enter the result as a percentage . . . . .	3 %
• For day-care facilities not used exclusively for business, also complete lines 4-6. • All others, skip lines 4-6 and enter the amount from line 3 on line 7.		
4	Multiply days used for day care during year by hours used per day . . . . .	4 hr.
5	Total hours available for use during the year (365 days × 24 hours). See instructions . . . . .	5 8,760 hr.
6	Divide line 4 by line 5. Enter the result as a decimal amount . . . . .	6
7	Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3 . . . . . ▶	7 %
<b>Part II Figure Your Allowable Deduction</b>		
8	Enter the amount from Schedule C, line 29, plus any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions. See instructions for columns (a) and (b) before completing lines 9-20.	8
	(a) Direct expenses      (b) Indirect expenses	
9	Casualty losses. See instructions . . . . .	9
10	Deductible mortgage interest. See instructions . . . . .	10
11	Real estate taxes. See instructions . . . . .	11
12	Add lines 9, 10, and 11. . . . .	12
13	Multiply line 12, column (b) by line 7 . . . . .	13
14	Add line 12, column (a) and line 13. . . . .	14
15	Subtract line 14 from line 8. If zero or less, enter -0- . . . . .	15
16	Excess mortgage interest. See instructions . . . . .	16
17	Insurance . . . . .	17
18	Repairs and maintenance . . . . .	18
19	Utilities . . . . .	19
20	Other expenses. See instructions . . . . .	20
21	Add lines 16 through 20 . . . . .	21
22	Multiply line 21, column (b) by line 7 . . . . .	22
23	Carryover of operating expenses from 1997 Form 8829, line 41 . . . . .	23
24	Add line 21 in column (a), line 22, and line 23 . . . . .	24
25	Allowable operating expenses. Enter the smaller of line 15 or line 24 . . . . .	25
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15 . . . . .	26
27	Excess casualty losses. See instructions . . . . .	27
28	Depreciation of your home from Part III below . . . . .	28
29	Carryover of excess casualty losses and depreciation from 1997 Form 8829, line 42 . . . . .	29
30	Add lines 27 through 29 . . . . .	30
31	Allowable excess casualty losses and depreciation. Enter the smaller of line 26 or line 30 . . . . .	31
32	Add lines 14, 25, and 31 . . . . .	32
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to Form 4684, Section B . . . . .	33
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions ▶	34
<b>Part III Depreciation of Your Home</b>		
35	Enter the smaller of your home's adjusted basis or its fair market value. See instructions . . . . .	35
36	Value of land included on line 35 . . . . .	36
37	Basis of building. Subtract line 36 from line 35 . . . . .	37
38	Business basis of building. Multiply line 37 by line 7 . . . . .	38
39	Depreciation percentage. See instructions . . . . .	39 %
40	Depreciation allowable. Multiply line 38 by line 39. Enter here and on line 28 above. See instructions . . . . .	40
<b>Part IV Carryover of Unallowed Expenses to 1999</b>		
41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0- . . . . .	41
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0- . . . . .	42
For Paperwork Reduction Act Notice, see page 3 of separate instructions.		

## ANSWERS

## Lesson 2

## Exercise 1

1. Form SS-4, APPLICATION FOR EMPLOYER IDENTIFICATION NUMBER.
2. Form W-4.
3. (A1) 6.2% social security tax rate and  
(A2) 1.45% Medicare tax rate  
(B) Same as above.  
(C) \$72,600 wage base limit in 1999 for social security tax.  
(D) No wage base limit for Medicare tax.
4. (A) Form W-2.  
(B) By January 31 of the following year.
5. Form 1099-MISC.
6. 31%.
7. Form W-5.
8. Forms W-2c and W-3c.

## ANSWERS

## Lesson 3, Part 1

## Exercise 1

Deposit Date	Amount
05/15/99	\$1,343.82
06/15/99	2,491.56
07/15/99	2,241.62
Total	6,077.00

See filled-in Exhibit 3.6 page A-3.

## Exercise 2

Social Security Tax	<u>    0</u>
Medicare Tax	<u>    0</u>
Federal Income Tax	<u>   12</u>

## Exercise 3

Deposit Date by	Amount	Monthly Amount
Wednesday 10/6	\$10,528.82	
Wednesday 10/20	10,253.20	\$30,296.52
Wednesday 11/3	9,514.50	
Wednesday 11/17	9,975.28	
Wednesday 12/1	9,423.74	19,399.02
Wednesday 12/15	10,528.82	
Wednesday 12/29	10,528.82	
Wednesday 1/5	764.00	21,821.64
Total	71,517.18	71,517.18

See filled-in Exhibit 3.7 page A-4.

EXHIBIT 3.6 - FILLED-IN FORM 941

**Form 941**  
(Rev. January 1999)  
Department of the Treasury  
Internal Revenue Service

**Employer's Quarterly Federal Tax Return**  
▶ See separate instructions for information on completing this return.  
Please type or print.

OMB No. 1545-0029

Enter state code for state in which deposits were made ONLY if different from state in address to the right (see page 2 of instructions) ▶

Name (as distinguished from trade name) **GREEN FOR EVER, INC.**  
Trade name, if any

Date quarter ended **6-30-1999**

Employer identification number **10-1234567**  
City, state, and ZIP code **AUGUSTA, GA 32599**

Address (number and street) **925 FERN AVE.**

	1	1	1	1	1	1	1	1	1	1	1	1	1	1	2	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5
IRS Use																																																														

If you do not have to file returns in the future, check here ▶  and enter date final wages paid ▶

If you are a seasonal employer, see **Seasonal employers** on page 1 of the instructions and check here ▶

**1** Number of employees in the pay period that includes March 12th ▶ **1**

<b>2</b> Total wages and tips, plus other compensation . . . . .	<b>2</b>	<b>26,830</b>	<b>00</b>
<b>3</b> Total income tax withheld from wages, tips, and sick pay . . . . .	<b>3</b>	<b>4,972</b>	<b>00</b>
<b>4</b> Adjustment of withheld income tax for preceding quarters of calendar year . . . . .	<b>4</b>		
<b>5</b> Adjusted total of income tax withheld (line 3 as adjusted by line 4—see instructions) . . . . .	<b>5</b>	<b>4,972</b>	<b>00</b>
<b>6</b> Taxable social security wages . . . . .	<b>6a</b>	<b>26,830</b>	<b>00</b>
			$\times 12.4\% (.124) =$
<b>6c</b> Taxable social security tips . . . . .	<b>6c</b>		$\times 12.4\% (.124) =$
<b>7a</b> Taxable Medicare wages and tips . . . . .	<b>7a</b>	<b>26,830</b>	<b>00</b>
			$\times 2.9\% (.029) =$
<b>8</b> Total social security and Medicare taxes (add lines 6b, 6d, and 7b). Check here if wages are not subject to social security and/or Medicare tax . . . . .	<b>8</b>	<b>4,104</b>	<b>99</b>
<b>9</b> Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ . . . . .	<b>9</b>		<b>01</b>
<b>10</b> Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9—see instructions) . . . . .	<b>10</b>	<b>4,105</b>	<b>00</b>
<b>11</b> Total taxes (add lines 5 and 10) . . . . .	<b>11</b>	<b>6,077</b>	<b>00</b>
<b>12</b> Advance earned income credit (EIC) payments made to employees . . . . .	<b>12</b>		
<b>13</b> Net taxes (subtract line 12 from line 11). If \$1,000 or more, this must equal line 17, column (d) below (or line D of Schedule B (Form 941)) . . . . .	<b>13</b>	<b>6,077</b>	<b>00</b>
<b>14</b> Total deposits for quarter, including overpayment applied from a prior quarter . . . . .	<b>14</b>	<b>6,077</b>	<b>00</b>
<b>15</b> Balance due (subtract line 14 from line 13). See instructions . . . . .	<b>15</b>		

**16** Overpayment. If line 14 is more than line 13, enter excess here ▶ \$ . . . . .

and check if to be:  Applied to next return OR  Refunded.

- All filers: If line 13 is less than \$1,000, you need not complete line 17 or Schedule B (Form 941).
- Semiweekly schedule depositors: Complete Schedule B (Form 941) and check here . . . . . ▶
- Monthly schedule depositors: Complete line 17, columns (a) through (d), and check here . . . . . ▶

<b>17</b> Monthly Summary of Federal Tax Liability. Do not complete if you were a semiweekly schedule depositor.			
(a) First month liability	(b) Second month liability	(c) Third month liability	(d) Total liability for quarter
<b>1,343.82</b>	<b>2,491.56</b>	<b>2,241.62</b>	<b>6,077.00</b>

**Sign Here** Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature ▶ **R. M. Green** Print Your Name and Title ▶ **R. M. GREEN, TREAS.** Date ▶ **7/29/99**

For Privacy Act and Paperwork Reduction Act Notice, see back of form. Cat. No. 17001Z Form 941 (Rev. 1-99)

EXHIBIT 3.7 - FILLED-IN FORM 941

Form <b>941</b> (Rev. January 1999) Department of the Treasury Internal Revenue Service	<b>Employer's Quarterly Federal Tax Return</b> ▶ See separate instructions for information on completing this return. Please type or print.	OMB No. 1545-0029 T FF FD FP I T																																																			
Enter state code for state in which deposits were made ONLY if different from state in address to the right ▶ <input type="checkbox"/> 1 2 of instructions).	Name (as distinguished from trade name) <b>PAUL'S AUTO SHOP, INC.</b> Trade name, if any	Date quarter ended <b>12-31-1999</b> Employer identification number <b>10-9876543</b> City, state, and ZIP code <b>CANNO, LA 88877</b>																																																			
Address (number and street) <b>425 AUTO STRIP DR.</b>																																																					
If address is different from prior return, check here ▶ <input type="checkbox"/>	IRS Use <table border="1" style="width:100%; border-collapse: collapse;"> <tr> <td style="width:10%;">1</td><td style="width:10%;">2</td> <td style="width:10%;">3</td><td style="width:10%;">3</td><td style="width:10%;">3</td><td style="width:10%;">3</td><td style="width:10%;">3</td><td style="width:10%;">3</td><td style="width:10%;">3</td><td style="width:10%;">3</td><td style="width:10%;">4</td><td style="width:10%;">4</td><td style="width:10%;">4</td> <td style="width:10%;">5</td><td style="width:10%;">5</td><td style="width:10%;">5</td> </tr> <tr> <td>6</td><td>7</td><td>8</td><td>8</td><td>8</td><td>8</td><td>8</td><td>8</td><td>8</td><td>8</td><td>8</td> <td>9</td><td>9</td><td>9</td><td>9</td><td>9</td><td>9</td><td>9</td><td>9</td><td>9</td><td>10</td><td>10</td><td>10</td> <td>10</td><td>10</td><td>10</td> </tr> </table>		1	1	1	1	1	1	1	1	1	1	2	3	3	3	3	3	3	3	3	4	4	4	5	5	5	6	7	8	8	8	8	8	8	8	8	8	9	9	9	9	9	9	9	9	9	10	10	10	10	10	10
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6	7	8	8	8	8	8	8	8	8	8	9	9	9	9	9	9	9	9	9	10	10	10	10	10	10																												
If you do not have to file returns in the future, check here ▶ <input type="checkbox"/> and enter date final wages paid ▶ _____ If you are a seasonal employer, see <b>Seasonal employers</b> on page 1 of the instructions and check here ▶ <input type="checkbox"/>																																																					
1 Number of employees in the pay period that includes March 12th . ▶ <b>1</b>																																																					
2 Total wages and tips, plus other compensation . . . . .		2 <b>206,460 00</b>																																																			
3 Total income tax withheld from wages, tips, and sick pay . . . . .		3 <b>46,165 00</b>																																																			
4 Adjustment of withheld income tax for preceding quarters of calendar year . . . . .		4																																																			
5 Adjusted total of income tax withheld (line 3 as adjusted by line 4—see instructions) . . . . .		5 <b>40,165 00</b>																																																			
6 Taxable social security wages . . . . .		6a <b>206,460 00</b> × 12.4% (.124) =																																																			
Taxable social security tips . . . . .		6c × 12.4% (.124) =																																																			
7 Taxable Medicare wages and tips . . . . .		7a <b>206,460 00</b> × 2.9% (.029) =																																																			
8 Total social security and Medicare taxes (add lines 6b, 6d, and 7b). Check here if wages are not subject to social security and/or Medicare tax . . . . .		8 <b>31,588 38</b>																																																			
9 Adjustment of social security and Medicare taxes (see instructions for required explanation) Sick Pay \$ _____ ± Fractions of Cents \$ <b>&lt;20&gt;</b> ± Other \$ _____ =		9 <b>&lt;20&gt;</b>																																																			
10 Adjusted total of social security and Medicare taxes (line 8 as adjusted by line 9—see instructions) . . . . .		10 <b>31,588 18</b>																																																			
11 Total taxes (add lines 5 and 10) . . . . .		11 <b>71,753 18</b>																																																			
12 Advance earned income credit (EIC) payments made to employees . . . . .		12 <b>236 00</b>																																																			
13 Net taxes (subtract line 12 from line 11). If \$1,000 or more, this must equal line 17, column (d) below (or line D of Schedule B (Form 941)) . . . . .		13 <b>71,517 18</b>																																																			
14 Total deposits for quarter, including overpayment applied from a prior quarter . . . . .		14 <b>71,517 18</b>																																																			
15 Balance due (subtract line 14 from line 13). See instructions . . . . .		15																																																			
16 Overpayment. If line 14 is more than line 13, enter excess here ▶ \$ _____ and check if to be: <input type="checkbox"/> Applied to next return OR <input type="checkbox"/> Refunded. • All filers: If line 13 is less than \$1,000, you need not complete line 17 or Schedule B (Form 941). • Semiweekly schedule depositors: Complete Schedule B (Form 941) and check here . . . . . ▶ <input checked="" type="checkbox"/> • Monthly schedule depositors: Complete line 17, columns (a) through (d), and check here . . . . . ▶ <input type="checkbox"/>																																																					
17 Monthly Summary of Federal Tax Liability. Do not complete if you were a semiweekly schedule depositor.																																																					
(a) First month liability	(b) Second month liability	(c) Third month liability	(d) Total liability for quarter																																																		
<b>30,296.52</b>	<b>19,399.02</b>	<b>21,821.64</b>	<b>71,517.18</b>																																																		
Sign Here Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.																																																					
Signature ▶ <b>Paul Potter</b>		Print Your Name and Title ▶ <b>PAUL POTTER, PRES</b> Date ▶ <b>1/28/00</b>																																																			
For Privacy Act and Paperwork Reduction Act Notice, see back of form.		Cat. No. 17001Z Form 941 (Rev. 1-99)																																																			

## ANSWERS

## Lesson 3, Part 2

### Exercise 1

- (A) \$30,600
- (B) \$244.80
- (C) 04/30/99
- (D) \$11,200
- (E) \$89.60
- (F) No deposit required for under \$100.
- (G) 90%
- (H) 0%

### Exercise 2

- (A) 08/02/99
- (B) \$101.60
- (C) \$44.00

See filled-in Exhibit 3.12 page A-6.

EXHIBIT 3.12 - FILLED-IN FORM 940-EZ

Form <b>940-EZ</b> Department of the Treasury Internal Revenue Service (0)	<b>Employer's Annual Federal Unemployment (FUTA) Tax Return</b> ▶ For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.	OMB No. 1545-1110 <div style="border: 1px solid black; padding: 5px; display: inline-block;"> <b>1998</b> </div>												
Name (as distinguished from trade name) <u>ACME, INC.</u> Calendar year _____ Trade name, if any _____		<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td>T</td><td></td></tr> <tr><td>FF</td><td></td></tr> <tr><td>FD</td><td></td></tr> <tr><td>FP</td><td></td></tr> <tr><td>I</td><td></td></tr> <tr><td>T</td><td></td></tr> </table>	T		FF		FD		FP		I		T	
T														
FF														
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FP														
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T														
Address and ZIP code <u>123 FIRST ST. CEDAR, MI 49621</u>		Employer identification number <u>10-7654321</u>												
Answer the questions under <b>Who May Use Form 940-EZ</b> on page 2. If you cannot use Form 940-EZ, you must use Form 940 instead.														
A Enter the amount of contributions paid to your state unemployment fund. (See separate instructions.) ▶ \$ <u>491.40</u>														
B (1) Enter the name of the state where you have to pay contributions ▶ <u>MICHIGAN</u> (2) Enter your state reporting number as shown on your state unemployment tax return ▶ <u>12345</u>														
If you will not have to file returns in the future, check here (see Who must file in separate instructions) and complete and sign the return. ▶ <input type="checkbox"/>														
If this is an Amended Return, check here ▶ <input type="checkbox"/>														
<b>Part I Taxable Wages and FUTA Tax</b>														
1 Total payments (including payments shown on lines 2 and 3) during the calendar year for services of employees	1	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:10%;"></td><td style="width:10%; text-align: right;">26,000</td><td style="width:10%; text-align: right;">00</td></tr> </table>		26,000	00									
	26,000	00												
2 Exempt payments. (Explain all exempt payments, attaching additional sheets if necessary.) ▶	2													
3 Payments for services of more than \$7,000. Enter only amounts over the first \$7,000 paid to each employee. Do not include any exempt payments from line 2. The \$7,000 amount is the Federal wage base. Your state wage base may be different. Do not use your state wage limitation.	3	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:10%;"></td><td style="width:10%; text-align: right;">7,800</td><td style="width:10%; text-align: right;">00</td></tr> </table>		7,800	00									
	7,800	00												
4 Total exempt payments (add lines 2 and 3)	4	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:10%;"></td><td style="width:10%; text-align: right;">7,800</td><td style="width:10%; text-align: right;">00</td></tr> </table>		7,800	00									
	7,800	00												
5 Total taxable wages (subtract line 4 from line 1)	5	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:10%;"></td><td style="width:10%; text-align: right;">18,200</td><td style="width:10%; text-align: right;">00</td></tr> </table>		18,200	00									
	18,200	00												
6 FUTA tax. Multiply the wages on line 5 by .008 and enter here. (If the result is over \$100, also complete Part II.)	6	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:10%;"></td><td style="width:10%; text-align: right;">145</td><td style="width:10%; text-align: right;">60</td></tr> </table>		145	60									
	145	60												
7 Total FUTA tax deposited for the year, including any overpayment applied from a prior year	7	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:10%;"></td><td style="width:10%; text-align: right;">101</td><td style="width:10%; text-align: right;">60</td></tr> </table>		101	60									
	101	60												
8 Balance due (subtract line 7 from line 6). Pay to the "United States Treasury".	8	<table border="1" style="width:100%; border-collapse: collapse;"> <tr><td style="width:10%;"></td><td style="width:10%; text-align: right;">44</td><td style="width:10%; text-align: right;">00</td></tr> </table>		44	00									
	44	00												
9 Overpayment (subtract line 6 from line 7). Check if it is to be: <input type="checkbox"/> Applied to next return or <input type="checkbox"/> Refunded	9													
<b>Part II Record of Quarterly Federal Unemployment Tax Liability</b> (Do not include state liability.) Complete only if line 6 is over \$100.														
Quarter	First (Jan. 1 - Mar. 31)	Second (Apr. 1 - June 30)	Third (July 1 - Sept. 30)	Fourth (Oct. 1 - Dec. 31)	Total for year									
Liability for quarter	52.00	49.60	27.60	16.40	145.60									
Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and, to the best of my knowledge and belief, it is true, correct, and complete, and that no part of any payment made to a state unemployment fund claimed as a credit was, or is to be, deducted from the payments to employees.														
Signature ▶		Title (Owner, etc.) ▶		Date ▶										
See separate Instructions for Form 940-EZ for information on completing this form.			Cat. No. 10983G		Form 940-EZ (1998)									
<b>DETACH HERE</b>														
Form <b>940-EZ(V)</b> Department of the Treasury Internal Revenue Service	<b>Form 940-EZ Payment Voucher</b> Use this voucher only when making a payment with your return.			OMB No. 1545-1110 <div style="border: 1px solid black; padding: 5px; display: inline-block;"> <b>1998</b> </div>										
Complete boxes 1, 2, 3, and 4. Do not send cash, and do not staple your payment to this voucher. Make your check or money order payable to the "United States Treasury." Be sure to enter your employer identification number, "Form 940-EZ", and "1998" on your payment.														
1 Enter the amount of the payment you are making ▶ \$ <u>44.00</u>	2 Enter the first four letters of your last name (business name if partnership or corporation) <u>ACME</u>	3 Enter your employer identification number <u>10-7654321</u>												
Instructions for Box 2 —Individuals (sole proprietors, trusts, and estates)— Enter the first four letters of your last name. —Corporations and partnerships— Enter the first four characters of your business name (omit "The" if followed by more than one word).		4 Enter your name (individual name for sole proprietors) <u>ACME, INC.</u> Enter your address <u>123 FIRST ST.</u> Enter your city, state, and ZIP code <u>CEDAR, MI 49621</u>												

# Lesson 4

## EXHIBIT 4.4 - FILLED-IN FORM 8829

Form <b>8829</b> Department of the Treasury Internal Revenue Service (99)	<b>Expenses for Business Use of Your Home</b> ▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year. ▶ See separate instructions.	OMB No. 1545-1266 <b>1998</b> Attachment Sequence No. 66 Your social security number <b>131 001 0001</b>
Name(s) of proprietor(s) <b>FRANK</b>		
<b>Part I Part of Your Home Used for Business</b>		
1	Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples. See instructions . . . . .	1 280
2	Total area of home . . . . .	2 2,800
3	Divide line 1 by line 2. Enter the result as a percentage . . . . .	3 10 %
• For day-care facilities not used exclusively for business, also complete lines 4-6. • All others, skip lines 4-6 and enter the amount from line 3 on line 7.		
4	Multiply days used for day care during year by hours used per day . . . . .	4 hr.
5	Total hours available for use during the year (365 days × 24 hours). See instructions . . . . .	5 8,760 hr.
6	Divide line 4 by line 5. Enter the result as a decimal amount . . . . .	6
7	Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3 . . . . . ▶	7 10 %
<b>Part II Figure Your Allowable Deduction</b>		
8	Enter the amount from Schedule C, line 29, plus any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions. See instructions for columns (a) and (b) before completing lines 9-20.	8 30,000 -
	(a) Direct expenses      (b) Indirect expenses	
9	Casualty losses. See instructions . . . . .	9
10	Deductible mortgage interest. See instructions . . . . .	10 10,000 -
11	Real estate taxes. See instructions . . . . .	11 2,500 -
12	Add lines 9, 10, and 11. . . . .	12 12,500 -
13	Multiply line 12, column (b) by line 7 . . . . .	13 1,250 -
14	Add line 12, column (a) and line 13. . . . .	14 1,250 -
15	Subtract line 14 from line 8. If zero or less, enter -0-. . . . .	15 28,750 -
16	Excess mortgage interest. See instructions . . . . .	16
17	Insurance . . . . .	17 500 -
18	Repairs and maintenance . . . . .	18 200 - 2,000 -
19	Utilities . . . . .	19 2,200 -
20	Other expenses. See instructions . . . . .	20 -
21	Add lines 16 through 20 . . . . .	21 200 - 4,700 -
22	Multiply line 21, column (b) by line 7 . . . . .	22 470 -
23	Carryover of operating expenses from 1997 Form 8829, line 41 . . . . .	23
24	Add line 21 in column (a), line 22, and line 23 . . . . .	24 670 -
25	Allowable operating expenses. Enter the smaller of line 15 or line 24 . . . . .	25 670 -
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15 . . . . .	26 28,080 -
27	Excess casualty losses. See instructions . . . . .	27
28	Depreciation of your home from Part III below . . . . .	28 517 -
29	Carryover of excess casualty losses and depreciation from 1997 Form 8829, line 42 . . . . .	29
30	Add lines 27 through 29 . . . . .	30 517 -
31	Allowable excess casualty losses and depreciation. Enter the smaller of line 26 or line 30 . . . . .	31 517 -
32	Add lines 14, 25, and 31 . . . . .	32 2,437 -
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to Form 4684, Section B . . . . .	33 -
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions ▶	34 2,437 -
<b>Part III Depreciation of Your Home</b>		
35	Enter the smaller of your home's adjusted basis or its fair market value. See instructions . . . . .	35 250,000 -
36	Value of land included on line 35 . . . . .	36 40,000 -
37	Basis of building. Subtract line 36 from line 35 . . . . .	37 210,000 -
38	Business basis of building. Multiply line 37 by line 7 . . . . .	38 21,000 -
39	Depreciation percentage. See instructions . . . . .	39 2.461 %
40	Depreciation allowable. Multiply line 38 by line 39. Enter here and on line 28 above. See instructions . . . . .	40 517
<b>Part IV Carryover of Unallowed Expenses to 1999</b>		
41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0- . . . . .	41 -
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0- . . . . .	42 -
For Paperwork Reduction Act Notice, see page 3 of separate instructions.      Cat. No. 13232M      Form <b>8829</b> (1998)		

