Construction Industry

Federal Taxation Curriculum

Developed by the Internal Revenue Service

Small Business and Self-Employed
Taxpayer Education and Communication

Table of Contents

Please note that the information contained in this product is current as of March 31, 2004.

CONSTRUCTION INDUSTRY FEDERAL TAX CURRICULUM

Introduction

The IRS Construction Industry Curriculum is a federal tax curriculum for students pursuing a career in the Construction Industry.

It is IRS' intent to improve compliance and reduce taxpayer burden by providing this text to students in order that students may gain a better understanding of the tax laws and guidelines that govern federal income and employment taxes.

The curriculum provides an overview of the federal income and employment tax laws as they pertain to the Construction Industry. It is not all-inclusive. You may have other income sources and/or expense not discussed. For additional information visit the IRS Website or consult a tax professional of your choice.

In addition to your federal tax responsibilities, there are various state and local requirements that you need to be aware of such as state income tax, city income tax, and city business licensing procedures. These items are not covered in this material; therefore, we encourage you to contact the appropriate state and local agencies to learn more about their requirements.

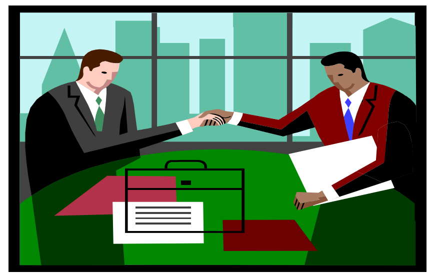
CHAPTER I
BENEFITS TO FILING A CORRECT TAX RETURN

"Filing a correct tax return will provide you with greater benefits today, as well as, tomorrow."

Reporting all of your income and paying the appropriate amount of tax may be confusing. You may wonder why you should comply with the law. This chapter helps to put into perspective the positive side of tax compliance.

How does filing a correct tax return increase my chances of getting a loan?

When you apply for a loan to purchase business equipment, a car, a house, or your own business, the financial institution will review your current and prior years' federal income tax returns to determine your loan suitability. The amount of money you can borrow will be based (in part) on the earnings/income you have reported on your tax return.



By accurately reporting all income received, your financial picture is clearer, and you will be more apt to receive the amount of loan proceeds you desire.

How does filing a correct tax return affect my Social Security benefits?

The benefits you receive from Social Security are calculated on the total combined earnings that have been recorded under your Social Security Number (SSN). Correctly reporting all of your income, including tips, will determine how much Social Security is paid into your account.

Social Security is not only for retirement purposes. The benefits also cover individuals who are injured or become disabled. If something happens to you, your spouse and your children can receive benefits based on your reported earnings.

If you are an employee, based upon the amount of wages earned, your employer provides matching funds for Social Security and Medicare Taxes.

If you are a self-employed person, you are responsible for reporting and paying self-employment tax (which is your Social Security and Medicare Taxes) by completing Schedule SE.

How does filing a correct tax return affect my unemployment compensation?

If you become unemployed, benefits are paid to you based on the wages you have reported. Unemployment compensation is available for employees only. As an employee, your employer makes payments to an unemployment fund.

NOTE: The laws governing unemployment benefits vary by jurisdiction. For more information, contact the appropriate agency in your state that handles unemployment compensation.

How does filing a correct tax return affect my workers' compensation benefits?

If you are an employee and are injured on the job, you are entitled to collect workers' compensation. Workers' compensation is based on wages and tips reported. Workers' compensation is not a federal program. As of 2002 all states, except Texas, mandate that employers carry workers' compensation insurance. This is an employer paid private insurance.

What other benefits might I receive by filing a correct tax return?

Filing a correct tax return and claiming all the ordinary and necessary business expenses that you are entitled to may reduce the amount of tax you owe and will provide greater working capital for you to use in your business.

Your employer may offer other benefits based on your wages; such as life insurance, disability insurance, 401K retirement plans, and the right to purchase stock options. You will need to check with your employer about these benefits.

Filing a correct tax return will provide you with peace of mind. If you are selected for an audit, you will feel confident that your tax return was accurately prepared.

CHAPTER II
INCOME

Internal Revenue Code (IRC) Section 61 states that gross income is all income from all sources, such as compensation for services, business income, interest, rents, dividends, and gains from the sale of property. Unless specifically excluded by the Internal Revenue Code, all income is subject to the federal income tax.

What is Income?

The money you receive from your work, whether it is wages, commissions or tips is taxable. This is true whether you are an employee or a subcontractor. The income you earn from all side jobs is taxable.

It does not matter whether you:

- Are paid by cash or check,
- Get a credit on a bill,
- Receive other goods or services in exchange,
- Collect the payment later, or
- Receive a Form 1099 or W-2 showing the amount of income you earned.

Goods and services received in lieu of cash are a “barter exchange.” The fair market value of those goods and services you receive should be included as taxable income.

Example 1
Joe, an employee of ABC, Inc., installs cabinets. He also does remodeling side jobs. In addition to his wages from ABC, Inc., Joe’s income includes everything he earns from his side jobs, whether or not he receives a Form 1099. **When you work as an employee, your employer gives you a W-2 form that shows the income you have earned. When you work for yourself, you may or may not receive a Form 1099 from the people for whom you work. However, you are responsible for keeping track of and reporting all of your income.**

Example 2

John agrees to replace the flooring in Tim Jones' office. Tim is a bookkeeper. In return, Tim agrees to provide free bookkeeping services for John, valued at $500. John must include this $500 in gross income. Tim must also include the value of John's service in income.

How to Report Income

Whether you prepare your own tax return or pay a tax preparer, you need to know the tax law, so you can file an accurate tax return.

Both employee wages and sole proprietor business income are reported on Form 1040, *U.S. Individual Income Tax Return*. Sole proprietor business income is first reported on Schedule C or Schedule C-EZ. *Profit or Loss from Business.* A Schedule SE, *Self-Employment Tax*, must be filed to report the Social Security and Medicare Taxes on net profits of $400 or more. Business income includes amounts that are properly shown on Forms 1099-MISC box 7, as non-employee compensation.

Profits or losses from partnerships (and LLCs taxed as partnerships) are reported by the partnership on Form 1065, *U.S. Partnership Return of Income*, an information return that summarizes the business activity of the partnership. The partnership gives each partner a Schedule K-1 (Form 1065), *Partner's Share Of Income, Credits, Deductions, Etc*. Then each partner uses their Schedule K-1 to complete Part II of Schedule E (Form 1040), *Supplemental Income And Loss*, and any other forms and schedules the partner must file with his or her individual return.

S corporations file Form 1120S, *U.S. Income Tax Return For An S Corporation*, and only pay tax on any items that are not passed 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 Part II of schedule E (Form 1040), and any other forms and schedules the shareholder must file with his or her individual return.

Profits of a regular corporation are taxed to the corporation on either Form 1120-A, *U.S. Corporation Short-Form Income Tax Return* or Form 1120, *U.S. Corporation Income Tax Return*.

What Is An Accounting Method?

Every taxpayer reports income and expenses on his or her tax return according to a method of accounting. An accounting method is a set of rules used to determine when and how to report income and expenses. Basically, accounting methods are divided into two categories -- the cash method and the accrual method. Most construction businesses use an accrual method for their overall method of accounting.

There are several different accrual methods. The Completed Contract Method (CCM) and the Percentage of Completion Method (PCM) are the main types of accrual methods used in the construction industry. Under the Completed Contract Method, all the income and expenses from the contract are reported in the year the project is completed and accepted by the customer. Under the Percentage of Completion Method, income is reported in proportion to the percentage of costs incurred to date when compared to total estimated costs for the contract. Accounting methods will be discussed in detail in Chapter VII.

You must use an accounting method that clearly shows your income. An accounting method clearly reflects your income when it treats all income and expenses the same from year to year and is appropriate for your line of work. Choosing the right method is important to your business, because it will affect when you report income and deduct expenses. Accounting methods will be discussed in detail later in this course.

There are special tax rules that control the accounting method you must use for your construction business. Generally, you choose your tax accounting method when you file your first tax return for the business.

Your choice of accounting method depends on:

- The type of contracts you have,
- Your contracts' completion status at the end of your tax year, and
- Your average annual gross receipts.

Most construction businesses use two different tax accounting methods: one for their long-term contracts and one overall method for everything else. A long-term contract is any contract that is not completed in the same year it's started. Unlike long-term capital gain or loss, the definition of “long-term contract” has nothing to do with the duration of the contract, but rather with whether a contract is completed within a single tax year.

Cash Method of Accounting

One method that some construction contractors can use for both their overall method and for their long-term contracts is the cash method. However, there are significant limitations on who can use this method.

A contractor using the cash method of accounting reports cash receipts as income when received and deducts expenses when paid. If you pay an expense that benefits you for more than one tax year, you must spread the cost over the period you receive the benefit.

There are two situations in which your use of the cash method of accounting can be limited. First, you are not allowed to use the cash method if your business is a corporation or a partnership with a C corporation as a partner, with average annual gross receipts exceeding $5 million. There is no exception to this limitation.

Second, depending on what type of business you have, you may not be allowed to use the cash method, if your total purchases of "merchandise" for the year are "substantial" compared to your total gross income for the year.

The term “merchandise” includes any item physically incorporated in a product you transfer to your customers. For example, the lumber used to frame a building is merchandise for tax purposes. In the construction industry, merchandise is commonly called “materials.”

Merchandise is generally considered to be "substantial" when it is at least 10% to 15% of your gross income for the year. This percentage is not a hard and fast rule, but a guideline used in some court cases.

Example 3
You pay $1,000 in Year 1 for a business insurance policy that is effective for one year, beginning July 1. You can deduct $500 in Year 1 and $500 in Year 2.

Accrual Method of Accounting

If you can't use the cash method, you must choose an accrual method of accounting. In the construction industry, there are several specialized accrual methods available, each of which has its own set of rules and limitations. In general, all accrual methods attempt to match the expenses that relate to a specific contract to the income from that contract.

You can find additional information on income and accounting methods in Publication 334, *Tax Guide for Small Business* and Publication 538, *Accounting Periods and Methods*.

For an in-depth discussion on accounting methods refer to Chapter VII, "Accounting Methods ."

CHAPTER III
BUSINESS EXPENSES

It is important to understand how and when a business expense can be deducted. Most common business expenses can be deducted in the year they are incurred. Expenses for business assets that are expected to last a year or longer must be capitalized and depreciated over their useful lives.

DEDUCTIBLE EXPENSES

To be deductible business expenses must be:

- ***Ordinary*** - one that is common and accepted in your trade or business AND
- ***Necessary*** - one that is helpful and appropriate for your trade or business

Both conditions must be met. An expense does not have to be crucial to your business to be deductible.

Types of Business Expenses

Common business expenses that may be deducted in the year incurred include the following:

- Utilities
- Car and truck expenses
- Advertising
- Employee salaries
- Trade association dues
- Rent expense
- Supplies
- Continuing education - A class that enhances your current business knowledge
- Small tools and other business assets expected to last one year or less, such as a wrench, hammer, grinder, or other hand tools
- Steel toe work boots
- Business licenses

Capitalized Expenses

Examples of common business expenses that are usually capitalized and depreciated over more than one year include the following:

- Cement mixer
- Compressor
- Ladder
- Other heavy machinery
- Buildings and real property (but the cost of land may never be expensed)

Sometimes you can elect to deduct even these items (except for buildings and real property) in the year acquired.

NON-DEDUCTIBLE EXPENSES

Every expense is not deductible. Some expenses are considered personal and cannot be deducted at all. Examples of these expenses

- Clothing that can be worn off the job site
- Fines and penalties
- Non-business use of vehicles or computers

Other expenses, in particular certain meal and entertainment expenses, may be deductible in part or only if certain conditions are met.

Be aware of abusive tax schemes such as Home-Based Business tax schemes. An abusive tax scheme is any investment scheme or promotion that claims to allow a person to deduct what would normally be a personal expense. As always, a true business purpose must exist prior to claiming any business expense. For more information on this subject, please refer Publication 4035, *Is it Too Good to be True? – Home-Based Business Tax Avoidance Schemes*.

HOME OFFICE EXPENSES

To deduct expenses related to the business use of part of your home, certain specific tests must be met. Even then, the deduction may be limited.

Your use of the business part of your home must be:

- Exclusive
- Regular AND
- For your trade or business

Additionally, the business part of your home must be ***ONE*** of the following:

- Your principal place of business
- A place where your meet or deal with customers in the normal course of your trade or business, or
- A separate structure (not attached to your home) you use in connection with your trade or business.

The expenses partially deductible as home office expenses are as follows:

- Insurance
- Utilities and services
- Rent
- Repairs
- Security System
- Depreciation

You can find detailed information on home office deductions in Publication 587, *Business Use of Your Home*.

TRAVEL AND ENTERTAINMENT

You may be able to deduct the ordinary and necessary business-related expenses you have for:

- Local Transportation
- Out-of-Town Travel
- Meals and Entertainment Expenses
- Gifts

Remember: An ***ordinary expense*** is one that is common and accepted in your field of trade, business, or profession. A ***necessary expense*** is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.

The following information explains what expenses are deductible and what records you need to prove your expenses.

Transportation

We are going to discuss expenses you can deduct for business trips when you are not traveling away from home. Transportation expenses include the ordinary and necessary costs of all of the following:

- Getting from one workplace to another in the course of your business or profession when you are traveling within the city or general area that is your tax home. (Tax home will be discussed later in this chapter).
- Visiting clients or customers.
- Going to a business meeting away from your regular workplace.
- Getting from your home to a temporary workplace when you have one or more regular places of work. These temporary workplaces can be either within the area of your tax home or outside that area.

These expenses include the cost of transportation by air, rail, bus, taxi, etc., and the cost of driving and maintaining your car. The information in this chapter will focus on car expenses. Additional information on "transportation" can be found in IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

Automobile Expenses

If you use your automobile for business purposes, you ordinarily can deduct car expenses. You can use one of the two following methods to figure your deductible expenses.

- Standard mileage rate.
- Actual car expenses.

Standard Mileage Rate

You may be able to use the standard mileage rate to figure the deductible costs of operating your car for business purposes. For 2004, the standard mileage rate was ***37.5 cents a mile*** for all business miles. This rate is adjusted periodically so check for the recent rate.

The standard mileage rate includes the following costs when applying the cents per mile rate:

- Depreciation
- Garage rent
- Gas
- Insurance
- Lease payments
- Licenses
- Oil
- Registration fees
- Repair
- Tires

First year decision: To use the standard mileage rate for a car you own, you must choose to use it in the first year the car is available for use in your business. Then in later years, you can choose to use either the standard mileage rate or actual expenses.

If you want to use the standard mileage rate for a car you lease, you must use it for the entire lease period.

Standard mileage rate not allowed: You cannot use the standard mileage rate if you:

- Used the car for hire (such as a taxi)
- Used five or more cars at the same time (refer to the following section)
- Claimed a depreciation deduction for the car using any method other than straight line, for example, MACRS
- Claimed a section 179 deduction on the car
- Claimed the special depreciation allowance (discussed later) on the car
- Claimed actual car expenses after 1997 for a car you leased

Five or more cars: If you own five or more cars that are used for business at the same time, you can use the standard mileage rate for the business use of any care. However, you may be able to deduct your actual expenses for operating each of the cars in your business. Refer to *Actual Car Expenses* for information.

Use of Standard Mileage Rate is allowed for up to four vehicles simultaneously.

NOTE: You are ***not*** using two or more cars for business at the same time if you alternate using the cars for business (use each car at different times). In that situation, you can use the standard mileage rate.

Example 1

Tony owns three cars and two vans that he alternates using for his electrical business. He can use the standard mileage rate for the business mileage of the cars and vans.

Parking fees and tolls: In addition to using the standard mileage rate, you can deduct any business-related parking fees and tolls. (Parking fees that you pay to park your car at your place of work are nondeductible commuting expenses).

Actual Car Expenses

If you do not use the standard mileage rate, you may be able to deduct your actual car expenses.

Actual Car Expenses Include:

- Depreciation
- Lease Payments
- Licenses
- Gas
- Insurance
- Garage Rent
- Oil
- Parking Fees
- Registration Fees
- Repairs
- Tires
- Tolls

If you have fully depreciated a car that you still use in your business, you can continue to claim your other actual car expenses. Continue to keep records.

Business and personal use: If you use your car for both business and personal purposes, you must divide your expenses between business and personal use. You can divide your expense based on the miles driven for each purpose.

Example 2

You are a self-employed carpenter and drive your car 20,000 miles during the year: 12,000 miles for business and 8,000 miles for personal use. You can claim only 60% (12,000/20,000) of the cost of operating your car as a business expense.

Depreciation: Depreciation, which is included in actual car expenses, is an annual income tax deduction that allows you to recover the cost or other basis of certain property over the time you use the property. It is an allowance for the wear and tear of the property. There is a specific lesson on depreciation. You can also find information on depreciation in Publication 946, *How To Depreciate Property*.

Commuting Expenses

You cannot deduct the costs of taking a bus, trolley, subway, or taxi, or of driving a car between your home and your main or regular place of work. These costs are personal commuting expenses. You cannot deduct commuting expenses no matter how far your home is from your regular place of work. You cannot deduct commuting expenses even if you work during the commuting trip.

Standard Mileage Rate Summary

Either the standard mileage rate or the actual vehicle costs relating to business use of your automobile can be used as a business deduction. Travel costs from your home to your regular place of business are not deductible.

TRAVEL

For tax purposes, travel expenses are the ordinary and necessary expenses of traveling away from home for your business, profession, or job.

An ordinary expense is one that is common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for your business.

You are traveling away from home if:

- Your duties require you to be away from the general area of your tax home substantially longer than an ordinary work day, and
- You need to sleep or rest to meet the demands of your work while away from home.

Tax Home

To determine whether you are traveling away from home, you must first determine the location of your tax home.

Generally, your tax home is your regular place of business or post of duty, regardless of where you maintain your family home. It includes the ***entire city or general area*** in which your business or work is located.

If you have more than one regular place of business, your tax home is your main place of business.

If you do not have a regular or a main place of business because of the nature of your work, then your tax home may be the place where you regularly live. Refer to No main place of business or work, later.

Main place of business or work: If you have more than one place of work, consider the following when determining which one is your main place of business or work:

- The total time you ordinarily spend in each place.
- The level of your business activity in each place.
- Whether your income from each place is significant or insignificant.

Example 3

You live in Cincinnati where you have a seasonal job for eight months each year and earn $25,000. You work the other four months in Miami, also at a seasonal job, and earn $9,000. Cincinnati is your main place of work because you spend most of your time there and earn most of your income there.

No main place of business or work: You may have a tax home even if you do not have a regular or main place of work. Your tax home may be the home where you regularly live.

Factors used to determine tax home: Your tax home is where you reside IF you answer “yes” to all of the following three questions:

1. Do you conduct part of your business in the same area where you spend the night?
2. Do you duplicate your living expenses when you are away from that home for business?
3. Do you often use that home for lodging, or have a member of your family living in that home?

If you satisfy all three factors, your tax home is the home where you regularly live. If you satisfy only two factors, you may have a tax home depending on all the facts and circumstances. If you satisfy only one factor, you are a ***transient***; your tax home is wherever you work and you cannot deduct travel expenses.

Transient

If you do not have a regular place of business or post of duty and there is no place where you regularly live, you are considered a ***transient (an itinerant)*** and your tax home is wherever you work. As a transient, you cannot claim a travel expense deduction, because you are never considered to be traveling away from home.

Example 4

Keith works for various contractors in the same city where he lives. Several of the contractors send him out of town on jobs that last a few weeks. While Keith is away from his home, the costs are deductible.

Example 5

You are an outside contractor with a territory covering several states. Your employer's main office is in Newark, but you do not conduct any business there. Your work assignments are temporary, and you have no way of knowing where your future assignments will be located. You have a room in your sister's house in Dayton. You stay there for one or two weekends a year, but you do no work in the area. You do not pay your sister for the use of the room. You answered No to all of the three questions listed earlier under the section, "No main place of business or work." You are a transient and have no tax home.

Temporary Travel vs. Indefinite Travel

If your assignment or job away from your main place of work is ***temporary***, your tax home does not change. You are considered to be away from home for the whole period you are away from your main place of work. You can deduct your travel expenses if they otherwise qualify for deduction. Generally, a temporary assignment in a single location is one that is realistically expected to last (and does in fact last) for ***one year or less***.

However, if your assignment or job is ***indefinite***, the location of the assignment or job becomes your new tax home and you cannot deduct your travel expenses while there. An assignment or job in a single location is considered indefinite if it is realistically expected to last for ***more than one year***, whether or not it actually lasts for more than one year.

If your assignment is indefinite, you must include in your income any amounts you receive from your employer for living expenses, even if they are called travel allowances and you account to your employer for them. You may be able to deduct the cost of relocating to your new tax home as a moving expense.

Determining temporary or indefinite: You must determine if your assignment is temporary or indefinite when you start work. If you expect an assignment or job to last for one year or less, it is temporary unless there are facts and circumstances that indicate otherwise. An assignment or job that is initially temporary may become indefinite due to changed circumstances. A series of assignments to the same location, all for short periods but that together cover a long period, may be considered an indefinite assignment.

Example 6

You are a construction worker. You live and regularly work in Los Angeles. You are a member of a trade union in Los Angeles that helps you get work in the Los Angeles area. Because of a shortage of work, you took a job on a construction project in Fresno. Your job was scheduled to end in eight months. The job actually lasted 10 months.

You realistically expected the job in Fresno to last eight months. The job actually did last less than one year. The job is temporary and your tax home is still in Los Angeles. The travel expenses are deductible.

Example 7

The facts are the same as in Example 6, except that you realistically expected the work in Fresno to last 18 months. The job actually was completed in 10 months.

Your job in Fresno is indefinite, because you realistically expected the work to last longer than one year, even though it actually lasted less than one year. You cannot deduct any travel expenses you had in Fresno, because Fresno became your tax home.

Example 8

The facts are the same as in Example 6, except that you realistically expected the work in Fresno to last nine months. After eight months, however, you were asked to remain for seven more months (for a total actual stay of 15 months).

Initially, you realistically expected the job in Fresno to last for only nine months. However, due to changed circumstances occurring after eight months, it was no longer realistic for you to expect that the job in Fresno would last for one year or less. You can only deduct your travel expenses for the first eight months. You cannot deduct any travel expenses you had after that time because Fresno became your tax home when the job became indefinite.

What Travel Expenses Are Deductible?

Once you have determined that you are traveling away from your tax home, you can determine what travel expenses are deductible.

You can deduct ordinary and necessary expenses you have when you travel away from home on business. The type of expense you can deduct depends on the facts and your circumstances.

The table shown below summarizes travel expenses you may be able to deduct. You may have other deductible travel expenses that are not listed, depending on the facts and your circumstances.

When you travel away from home on business, you should keep records of all the expenses you have and any advances you receive from your employer. You can use a log, diary, notebook, or any other written record to keep track of your expenses.

Travel Expense Summary

Ordinary and necessary expenses you have when you travel away from home on business are deductible business expenses.

The following table shows examples of deductible travel expenses:

IF you have	THEN you can deduct the cost of…
Transportation	Travel by airplane, train, bus, or car between your home and your business destination
Taxi, commuter bus, and airport	Fares for these and other types of transportation that takes you between 1) The airport/station and your hotel, and 2) The hotel and work location of your customer
Baggage and Shipping	Sending baggage and display material between your regular and temporary work location.
Car	Operating and maintaining your car when traveling away from home on business. You can deduct actual or standard mileage rate, as well as business-related tolls/parking. If you rent a car while away from home on business, you can deduct only the business-use portion of the expenses.
Lodging/meals	Your lodging & meals if your business trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties.
Cleaning	Dry cleaning and laundry.
Telephone	Business calls while on your business trip. This includes business communication by fax machine or other devices
Tips	Tips you pay for any expenses in this chart
Other	Other similar ordinary and necessary expenses related to your business travel.

MEALS

You can deduct the cost of meals in either of the following situations:

1. It is necessary for you to stop for substantial sleep or rest to properly perform your duties while traveling away from home on business.
2. The meal is business-related entertainment.

Business-related entertainment is discussed in the next chapter. The following discussion deals only with meals that are not business-related entertainment.

Actual Cost

You can use the actual cost of your meals to figure the amount of your expense before reimbursement and application of the 50% deduction limit. If you use this method, you must keep records of your actual cost.

Standard Meal Allowance

Generally, you can use the "standard meal allowance" method as an alternative to the actual cost method. It allows you to use a set amount for your daily meals and incidental expenses (M&IE), instead of keeping records of your actual costs. The set amount varies depending on where and when you travel. If you use the standard meal allowance, you still must keep records to prove the time, place, and business purpose of your travel.

50% Limit May Apply: If you use the standard meal allowance method for meal expenses and you are not reimbursed, you can generally deduct only 50% of the standard meal allowance. If you are reimbursed and you are deducting amounts that are more than your reimbursements, you can deduct only 50% of the excess amount.

Incidental Expenses: These include, but are not limited to, your costs for the following items:

- Laundry, cleaning and pressing of clothing, and
- Fees and tips for persons who provide services, such as porters and baggage carriers.

Incidental expenses do not include taxicab fares, lodging taxes, or the costs of telegrams or telephone calls.

Who cannot use the standard meal allowance: You cannot use the standard meal allowance if you are related to your employer as defined below.

You are related to your employer if:

- Your employer is your brother or sister, half brother or half sister, spouse, ancestor, or lineal descendant,
- Your employer is a corporation in which you own, directly or indirectly, more than 10% in value of the outstanding stock, or

- Certain relationships (such as beneficiary) exist between you, a trust, and your employer.

Per Diem: If your employer reimburses you for your expenses using a per diem, you can generally use the allowance as proof for the amount of your expenses. A per diem satisfies the adequate accounting requirements for the amount of your expenses only if ***all four*** of the following conditions apply:

1. Your employer reasonably limits payments of your expenses to those that are ordinary and necessary in the conduct of the trade or business. The allowance is similar in form to and not more than the federal rate.
2. You prove the time, date, place, and business purpose of your expenses to your employer within a reasonable period of time.
3. You are not related to your employer.
4. Amount of standard meal allowance/per diem: The standard meal allowance is the federal M&IE rate. The regular federal per diem rate is the highest amount that the federal government will pay to its employees for lodging, meals, and incidental expenses only while they are traveling away from home in a particular area. Most major cities and many other localities in the United States are designated as high-cost areas, qualifying for higher standard meal allowances. These rates are listed in Publication 1542, *Per Diem Rates (For Travel Within the Continental United States)*.

You can also find this information on the GSA web site. If you travel to more than one location in one day, use the rate in effect for the area where you stop for sleep or rest.

The standard meal allowance rates do not apply to travel in Alaska, Hawaii, or any other locations outside the continental United States. The federal per diem rates for these locations are published monthly in the ***Maximum Travel Per Diem Allowances for Foreign Areas***. You can access foreign per diem rates at www.state.gov/m/a/als/prdm.

Flat Rate Payments for Travel: Many contractors pay their employees a flat rate for lodging and meals that is lower than the per diem amount. In this type of payment, 40 percent of the payment should be allocated towards meals and 60 percent should be allocated towards the lodging. Of course, the meal amount is still subject to 50% limitation.

Example 9

Vince, a construction supervisor, pays $40 per man each day to cover lodging and meals for out-of-town jobs. The following shows how the $40 amount is allocated between meal allowance and lodging:

Meals	**$40 x 40% = $16 per day for meals**
Lodging	**$40 x 60% = $24 per day for lodging**

Meal Expense Summary

The cost for meals while on a business trip is a deductible expense. Using either the actual costs or the standard meal allowance, the deduction is subject to the 50% meal limitation.

Entertainment

You may be able to deduct business-related entertainment expenses you have for entertaining a client, customer, or employee. You can deduct entertainment expenses only if they are both ordinary and necessary and meet one of the following two tests:

1. Directly-related test
2. Associated test

Both of these tests are explained later.

An ordinary expense is one that is common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for your business.

The amount you can deduct for entertainment expenses may be limited. Generally, you can deduct only 50% of your un-reimbursed entertainment expenses.

The Rules and Directly-Related Test

To meet the directly-related test for entertainment expenses (including entertainment-related meals), you must show that:

- The main purpose of the combined business and entertainment was the active conduct of business,
- Entertainment took place in a clear business setting, or
- You did engage in business with the person during the entertainment period, AND
- You had more than a general expectation of getting income or some other specific business benefit at some future time.

You must consider all the facts, including the nature of the business transacted and the reasons for conducting business during the entertainment. It is not necessary to devote more time to business than to entertainment. However, if the business discussion is only incidental to the entertainment, the entertainment expenses do not meet the directly-related test.

Clear Business Setting: If the entertainment takes place in a clear business setting and is for your business or work, the expenses are considered directly related to your business or work. The following situation is an example of entertainment in a clear business setting:

You entertain in a hospitality room at a convention where business goodwill is created through the display or discussion of business products.

Definitions are summarized in the table at the end of this section.

Expenses not considered directly related: Entertainment expenses generally are not considered directly related if you are not present or in situations where substantial distractions exist that generally prevent you from actively conducting business. The following are examples of situations where there are substantial distractions:

- A meeting or discussion at a nightclub, theater, or sporting event.
- A meeting or discussion during what is essentially a social gathering, such as a cocktail party.
- A meeting with a group that includes persons who are not business associates at places such as cocktail lounges, country clubs, golf clubs, athletic clubs, or vacation resorts.

Associated Test

Even if your expenses do not meet the directly-related test, they may meet the associated test.

To meet the associated test for entertainment expenses (including entertainment-related meals), you must show that the entertainment:

- Is associated with the active conduct of your trade or business, and
- Occurred directly before or after a substantial business discussion (defined later).

Associated with trade or business: Generally, an expense is associated with the active conduct of your trade or business if you can show that you had a clear business purpose for having the expense. The purpose may be to get new business or to encourage the continuation of an existing business relationship.

Substantial business discussion: Whether a business discussion is substantial depends on the facts of each case. A business discussion will not be considered substantial unless you can show that you actively engaged in the discussion, meeting, negotiation, or other business transaction to get income or some other specific business benefit.

The meeting does not have to be for any specified length of time, but you must show that the business discussion was substantial in relation to the meal or entertainment. It is not necessary that you devote more time to business than to entertainment. You do not have to discuss business during the meal or entertainment.

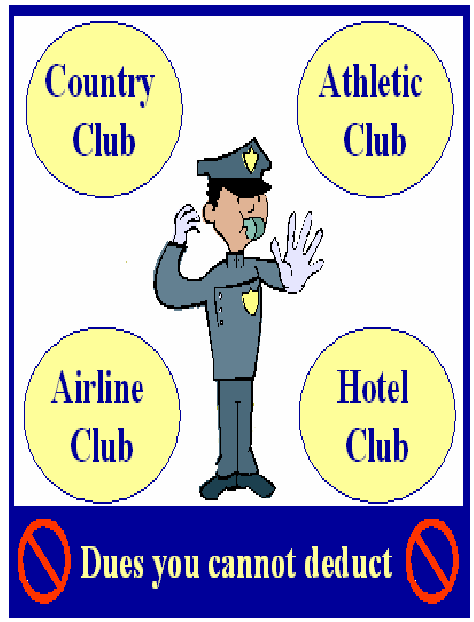
Directly before or after business discussion: If the entertainment is held on the same day as the business discussion, it is considered to be held directly before or after the business discussion.

If the entertainment and the business discussion are not held on the same day, you must consider the facts of each case to see if the associated test is met. Some of the facts to consider are the place, date, and duration of the business discussion. If you or your business associates are from out of town, you must also consider the dates of arrival and departure, and the reasons the entertainment and the discussion did not take place on the same day.

Example 10

A group of business associates comes from out of town to your place of business to hold a substantial business discussion on current construction equipment. If you entertain those business guests on the evening before the business discussion, or on the evening of the day following the business discussion, the entertainment generally is considered to be held directly before or after the discussion. The expense meets the associated test.

What Entertainment Expenses Are Deductible?



Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. Examples include entertaining guests at nightclubs; at social, athletic, and sporting clubs; at theaters; and at sporting events. However, the entertainment expenses considered to be deductible cannot be lavish or extravagant.

You ***cannot*** deduct dues (including initiation fees) for membership in any club organized for:

- Business,
- Pleasure,
- Recreation, or
- Other social purpose.

You also ***cannot*** deduct dues paid to:

- Country clubs,
- Golf and athletic clubs,
- Airline clubs,
- Hotel clubs, and
- Clubs operated to provide meals under circumstances generally considered to be conducive to business discussions.

50% Limit

In general, you can deduct only 50% of your business-related meal and entertainment expenses. The 50% limit applies to business meals or entertainment expenses you have while:

- Traveling away from home (whether eating alone or with others) on business,
- Entertaining customers at your place of business, a restaurant, or other location, or
- Attending a business convention or reception, business meeting, or business luncheon at a club.

Included expenses: Expenses subject to the 50% limit include:

- Taxes and tips relating to a business meal or entertainment activity,
- Cover charges for admission to a night club,
- Rent paid for a room in which you hold a dinner or cocktail party, and
- Amounts paid for parking at a sports arena.

The 50% limit on meal and entertainment expenses applies if the expense is otherwise deductible.

Example 11

You spend $100 for a business-related meal. If $40 of that amount is not allowable because it is lavish and extravagant, the remaining $60 is subject to the 50% limit. Your deduction cannot be more than $30 (50% x $60).

Example 12

Ralph and Norton contract jobs with one another. They go to lunch everyday. Ralph agrees to pay for lunches on Mondays and Wednesdays and Norton pays on Tuesdays and Thursdays. These meals would not be deductible because they represent a quid pro quo, or equal exchange agreement.

For additional information on "Entertainment," refer to Publication 463, Tr*avel, Entertainment, Gift, and Car Expenses*.

Entertainment Expense Summary

Business related entertainment costs are deductible costs. But to be eligible for the deduction, the entertainment must pass either the directly-related test or the associated test. The deduction is limited to 50% of the costs.

When Are Entertainment Expenses Deductible:

General rule	You can deduct ordinary and necessary expenses to entertain a client, customer, or employee if the expenses meet the directly-related test or the associated test.
Tests to be met	**Directly-related test** • Entertainment took place in a clear business setting, ***or*** • Main purpose of entertainment was the active conduct of business, ***and*** • You did engage in business with the person during the entertainment period, ***and*** • You had more than a general expectation of getting income or some other specific business benefit. **Associated test** • Entertainment is associated with your business, ***and*** • Entertainment directly precedes or follows a substantial business discussion.
Other rules	**Additional rules** • You cannot deduct the cost of your meal as an entertainment expense if you are claiming the meal as a travel expense. • You cannot deduct expenses that are lavish or extravagant under the circumstances. • You generally can deduct only 50% of your un-reimbursed entertainment expenses.

Gifts

If you give gifts in the course of your trade or business, you can deduct all or part of the cost. The following explains the limits and rules for deducting the costs of gifts.

$25 Limit

You can deduct no more than $25 for business gifts you give directly or indirectly to any one person during your tax year. If you give a gift to a member of a customer's family, the gift is generally considered to be an indirect gift to the customer. Also, spouses are jointly limited to $25 per year to any one person, even if they own separate businesses.

Exceptions

The following items are not considered gifts for purposes of the $25 limit:

1. An item that costs $4 or less and:
   - Has your name clearly and permanently imprinted on the gift, and
   - Is one of a number of identical items you widely distribute. Examples include pens, desk sets, and plastic bags and cases.
2. Signs, display racks, or other promotional material to be used on the business premises of the recipient.

Gift or entertainment: Any item that might be considered either a gift or entertainment generally will be considered entertainment. However, if you give a customer packaged food or beverages that you intend the customer to use at a later date, treat it as a gift.

If you give a customer tickets to a theater performance or sporting event and you do not go with the customer to the performance or event, you have a choice. You can treat the cost of the tickets as either a gift expense or an entertainment expense, whichever is to your advantage.

If you go with the customer to the event, you must treat the cost of the tickets as an entertainment expense. You cannot choose, in this case, to treat the cost of the tickets as a gift expense.

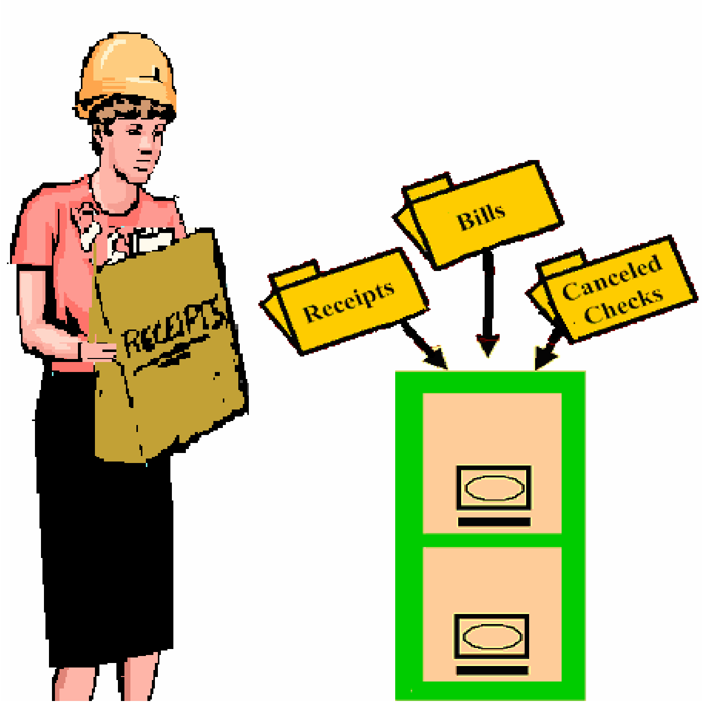
Business Gifts Summary

You can deduct no more than $25 for business gifts you give directly or indirectly to any one person during the tax year.

Recordkeeping

If you deduct travel, entertainment, gift, or transportation expenses, you must be able to prove certain elements of expense. You should keep the proof you need in an account book, diary, statement of expense, or similar record.

You should also keep documentary evidence that, together with your record, will support each element of an expense. You generally must have documents, such as receipts, canceled checks, or bills, to support your expenses. The following table is a summary of records you need to support the claimed expenses:



How To Prove Certain Business Expenses

THEN you must keep records that show details of the following elements.

If you have expense for:	**Amount**	**Time**	**Place or Description**	**Business Purpose and Business Relationship**
Travel	Cost of each separate expense for travel, lodging, and meals. Incidental expenses may be totaled in reasonable categories such as taxis, daily meals for traveler, etc.	Dates you left and returned for each trip and number of days spent on business.	Destination or area of your travel (name of city, town, or other designation.)	***Purpose:*** Business purpose for the expense or the business benefit gained or expected to be gained. ***Relationship:*** N/A
Entertainment	Cost of each separate expense. Incidental expenses such as taxis, telephones, etc., may be totaled on a daily basis.	Date of entertainment. (Also refer to Business Purpose)	Name and address or location of place of entertainment. Type of entertainment if not otherwise apparent. (Also refer to Business Purpose.)	***Purpose:*** Business purpose for the expense or the business benefit gained or expected to be gained. For entertainment, the nature of the business discussion or activity. If the entertainment was directly before or after a business discussion: the date, place, nature, and duration of the business discussion, and the identities of the persons who took part in both the business
Gifts	Cost of the gift.	Date of the gift.	Description of the gift.	

				discussion and the entertainment activity. ***Relationship:*** Occupations or other information (such as names, titles, or other designations) about the recipients that shows their business relationship to you. For entertainment, you must also prove that you or your employee was present if the entertainment was a business meal.
Transportation	Cost of each separate expense. For car expenses, the cost of the car and any improvements, the date you started using it for business, the mileage for each business use, and the total miles for the year.	Date of the expense. For car expenses the date of the use of the car.	Your business destination.	***Purpose:*** Business purpose for the expense. ***Relationship:*** N/A

For more information on recordkeeping, please refer to Chapter IV.

Supporting Information:

Supporting Documents:

Additional publications provided by the Internal Revenue Service include:

- Publication 463: Travel, Entertainment, Gift, and Car Expenses
- Publication 529: Miscellaneous Deductions
- Publication 535: Business Expenses
- Publication 1542: *Per Diem Rates*

Additional Resources

The Internal Revenue Service, in response to the needs of the business community, has created customer-focused products and services. We provide assistance to educate business customers and help them meet their taxpayer obligations and reduce taxpayer burden. For your reference, a list of these products and services follows:

Small Business/ Self-Employed Community Web Site
www.IRS.gov/businesses/small/
provides up-to-date information regarding business and industry.

Small Business Workshops
(http://www.IRS.gov/businesses/small/article/0,,id=97726,00.html)

Paying Federal Taxes Electronically
www.eftps.gov

EFTPS Customer Service
1-800-555-4477

Toll-free telephone assistance
1-800-829-1040

Forms and Publications
1-800-829-3676 (FORM)

IRS TaxFax Services
(703) 368-9694
(not a toll-free number) for forms and publications to be faxed to you

DEPRECIATION

Depreciation is an annual income tax deduction that allows you to recover the cost or other basis of certain property over the time you use the property. It is an allowance for the wear and tear, deterioration, or obsolescence of the property.

You can depreciate most types of tangible property, such as:

- Buildings
- Machinery
- Vehicles
- Furniture
- Equipment

You can find detailed information on depreciation deductions in Publication 946, *How To Depreciate Property*.

When Do You Deduct Business Expenses?

Under the cash method of accounting, expenses are deducted in the tax year you actually paid them, even if you incurred them in an earlier year. Under the accrual method, expenses are deducted in the year they are incurred.

How Do You Deduct Business Expenses?

If you are an employee, your business expenses are deducted on Form 2106, *Employee Business Expenses*. The total is then carried forward to Schedule A (Form 1040), if you itemize your deductions. Only the expenses that exceed 2% of your Adjusted Gross Income (AGI) would actually be allowed on Schedule A. If you do not itemize, you will not be able to deduct any of your employee business expenses.

NOTE: If your standard deduction is greater than your potential itemized deductions, the standard deduction amount should be used, as it is more beneficial to you. If you are self-employed or an independent contractor, your business expenses are deducted in part two of Schedule C.

Partnership deductions are listed on Form 1065. Each partner in a partnership uses the information from their Schedule K-1 (Form 1065) to report their expenses on forms and schedules the partner must file with his or her individual return. S corporation deductions are reported on Form 1120S. S corporation shareholders use the information from Schedule K-1 (Form 1120S) to report their expenses on forms and schedules the shareholder must file with his or her individual return.

Expenses for corporations are reported on the appropriate lines on Form 1120 or Form 1120-A.

Where Can You Find Additional Information?

The IRS website contains a wealth of information geared specifically toward the construction industry. You will find details on the major expenses affecting businesses and individuals. Also refer to Publication 535, *Business Expenses* and Publication 334, *Tax Guide for Small Business*.

CHAPTER IV
RECORDKEEPING

Recordkeeping is a critical business practice that enables your business to have accurate information related to income and expenses. You are required to keep receipts, sales slips, invoices, bank deposit slips, canceled checks and other documents to substantiate items of income, deductions, and credits. Recording these items in journals and ledgers will help you pay only the tax you owe.

Why Should You Keep Records?

There are many reasons why you need to keep good records. The most important reasons are listed below:

- Monitor Your Business Success
- Identify Your Sources of Income
- Identify Deductible Expenses
- Support Entries On Your Return In The Event You Are Audited
- It Is Required By Law

Monitor Your Business Success

You will be able to answer questions such as: How much is my business earning each week? What were my expenses last week, last month, or last year?

In addition, good recordkeeping enables you to identify changes you need to make in your business to be more successful. For instance, if you eliminated unwanted services or products that did not sell, you could increase your profits.

Identify Your Sources of Income

You may receive money from many sources. Good recordkeeping helps you identify and separate business and non-business income and taxable and nontaxable income. Good records will allow you to distinguish between the $500 birthday gift that you deposited, which is not taxable, from the $500 tip income that you deposited, which is taxable.

Identify Deductible Expenses

Regardless of your employment status, you may have deductible expenses that could reduce your taxable income. A good recordkeeping system will identify and document these deductible expenses throughout the year. Without an accurate recordkeeping system, you might lose the benefit of a business deduction.

Support Entries On Your Return In The Event You Are Audited

You must keep records to support all items shown on your income tax return. If the IRS examines any of your tax returns, you may be asked to explain or verify items you reported. If you are unable to present the supporting documents, you may pay additional taxes and penalties.

Required By Law

Internal Revenue Code Section 6001 requires taxpayers to keep records from which their tax can be determined. The regulations on income taxes contain only general recordkeeping requirements, but IRS can require individual taxpayers to keep specific records.

What Type Of Records Should You Keep?

You should keep records for any item you have listed on your tax return. ***It is strongly recommended that you keep business and personal funds separate.*** The best way to do this is to have a separate bank account for your business activities. The following are examples of the type of business income and business expense records you should keep.

Business Income Records

- Cash register tapes
- Invoices
- Bank deposit slips and bank statements
- Credit card charge slips
- Appointment book/calendar
- Receipt books
- Form(s) 1099-MISC received

Business Expense Records

- Invoices
- Account statements
- Receipts
- Cancelled checks
- Sales slips
- Credit card receipts
- Petty cash slips for small cash payments

These supporting documents need to show the amount paid and how it relates to your business. You should keep documents supporting the business purpose for the expense.

How Should You Keep Records?

The law does not require you to maintain your records in any particular way. You can select a recordkeeping system and accounting method that are suitable for your business as long as you are able to determine your income and deductible expenses.

A good recordkeeping system should be easy to use and understand, reliable, accurate, and consistent.

At the simplest level, a business may use a notebook to record taxable income as it is received and deductible expenses as they are paid. For most small businesses, the business checkbook is the main source of entries in the business books.

You may store your supporting documents in a file, shoebox, or any other type of container. Periodically, you should organize the documents by date and type of income and expense. You could separate deductible business expenses into categories such as rent, utilities, insurance, advertising, and professional publications.

No matter how you keep your records, they should be organized and easy to find.

How Long Must You Keep Records?

You must keep your records as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep records that support an item of income or deduction on a return until the period of limitations for that return expires.

The period of limitations is the period of time in which you can amend your return to claim a credit or refund, and the period of time that the IRS can assess additional tax. The following table contains the periods of limitation that apply to income tax returns. Unless otherwise stated, the years refer to the period after the return was filed. Returns filed before the due date are treated as filed on the due date.

Keep all employment tax records for at least four years after the tax return becomes due or is filed, or two years from the date the tax is paid, whichever is later.

Major purchases, such as buildings and equipment, may have special recordkeeping requirements. Please refer to Publication 946, *How To Depreciate Property*, for additional information.

IF	**THEN the period of limitation is:**
1. You owe additional tax and situations (2), (3), and (4), below, do not apply to you	3 years
2. You do not report income that you should report, and it is more than 25% of the gross income shown on the return	6 years
3. You file a fraudulent income tax return	No limit
4. You do not file a return	No limit
5. You file a claim for credit or refund* after you file your return	Later of 3 years after filing returns or two years after tax was paid
6. Your claim is due to a bad debt deduction	7 years
7. Your claim is due to a loss from worthless securities	7 years

* Individuals file a claim for credit or refund on Form 1040X

Where To Get More Information?

Refer to Publication 583, *Starting a Business and Keeping Records*, for more information.

CHAPTER V
WORKER CLASSIFICATION

For federal tax purposes, worker classification is an important issue. Worker classification affects how you pay your federal income tax, social security and Medicare taxes, and how you file your tax return. Classification affects your eligibility for employer benefits, as well as social security and Medicare benefits.

Types of Worker Classification

The obligations and responsibilities for each worker category are different. Proper worker classification will enable you to file and pay the correct tax. A worker can be classified as an employee or as an independent contractor.

Employee

An employee is an individual who performs services for you and is subject to control regarding what will be done AND how it will be done. It does not matter that you give the employee freedom of action. It matters that you have the right to control the details of how the services are performed.

Independent Contractor

If an individual performs services for you, but is not under your direct control, generally that person is an independent contractor or is self-employed. You, the contractor, have the right to control and direct only the result of the work and not the means and methods of accomplishing that result. Independent contractors are always self-employed. This means they are responsible for their recordkeeping, the timely filing of their returns, and the payment of taxes related to their business.

Note: An independent contractor may very well also be an employer. If you have workers who meet the definition of employee (refer to above), then you are an employer.

How Do You Make the Worker Classification Determination?

The courts have considered many factors in determining whether a worker is an employee or independent contractor. These relevant factors fall into three main categories:

- Behavioral control,
- Financial control, and
- Relationship or intent of the parties.

In each case, it is very important to consider all the facts – no single factor provides the answer.

Behavioral Control

Behavioral control factors indicate whether there is a right to direct or control how the work is done. A worker is an employee when a business has the right to direct and control the worker. The business does not have to actually direct or control the way the work is done, as long as the employer has the right to direct and control the way the work is done. The basic behavioral control factors include: type of instruction given, degree of instruction, evaluation systems and training provided by the business.

Type of instruction: This could include the following:

- When to work,
- Where to do the work,
- What tools or equipment to use,
- What workers to hire to assist with the work,
- Where to purchase supplies, and
- What order or sequence to follow.

Example 1

Tom is hired as a roofing supervisor. He must report to work by 7 a.m. and submit required reports. Tom is given a weekly work schedule. The contractor supplies the majority of tools and all the supplies. Based on the types of instruction, the contractor is in control of the manner and means by which Tom will perform his job. Thus, Tom is an employee.

Example 2

Sara is to provide the school district with four different proposed pool designs for a new high school. She must submit the proposed guidelines within two months. The school district also asks that she submit five copies of the suggested designs in spiral bound binders. Based on these behavioral control factors, Sara would be considered an independent contractor. The school has given Sara instructions, but not on how to perform the work.

In addition, weight must also be given to the DEGREE in which the instructions say how the job is to be done. The more detailed the instructions the worker is required to follow, the more control the business exercises over the worker. More control implies the person is an employee. Absence of detail in instructions reflects less control. Less control implies the person is an independent contractor.

Example 3

Jones, an air conditioning specialist, is hired to install a central unit. He is told what type of unit to install and where the unit should be located. Because Jones receives directions on *what* is to be done, as opposed to *how* the work is to be done, Jones is an independent contractor.

Example 4

Smith, an air conditioning specialist, works for Beacon Air. He is fully certified and seldom needs further instructions. Beacon Air retains the right to control how, when, and where he does his job. These indicators are consistent with employee status.

Degree of Instruction

This does not mean length of instruction. Highly-trained professionals, such as lawyers, roofers, accountants or air conditioning specialists may require little, if any, training and/or instruction on how to perform their services. The absence of NEED to instruct and control should not be confused with the absence of RIGHT to instruct and control. The key fact to consider is whether the business retains the RIGHT to control the worker regardless of whether the business actually exercises that right.

Evaluation Systems

If an evaluation system measures details of how the work was performed, then the worker is probably an employee. If the evaluation measures end result, the worker may be an independent contractor or employee, depending on other factors.

Example 5

Bob, a guidance counselor, receives his work performance evaluation. Some of the critical elements on which he was evaluated include: student case management, percentage increase in parent/teacher conferences, and participation in after school activities. Because this evaluation is measuring how the counseling job is being performed, we have evidence of an employee relationship.

Training

Training is a means of explaining detailed methods and procedures to be used in performing a task. Periodic or on-going training about procedures to follow and methods to be used indicates a business wants services performed in a particular manner. This type of training is strong evidence of an employer-employee relationship.

Example 6

When Bob the surveyor was hired, he was told he had to attend Friday training meetings every week, regarding such topics as state mandated reports, inventory, mapping, etc. On-going training of this type is an indication of an employer-employee relationship.

Financial Control

Financial control is having the right to direct or control the business part of the work. Examples of financial control include: determining how much to charge customers; management of business expenses and equipment purchases; and the ability to realize a profit or loss. A significant investment is not necessary for independent contractor status since some types of work do not require large expenditures.

Relationship or Intent of the Parties

Relationship or intent of the parties illustrates how the business owner and the worker perceive their relationship. Items to consider would be employee benefits and written contracts.

Summary of Worker Classification

Employer Responsibility

Each business has the responsibility to make the determination of whether a worker is an employee or an independent contractor.

Independent Contractor or an Employee

Financial control, behavioral control and type of relationship are the keys in determining if a worker is an employee or independent contractor. An employer-employee relationship exists when the person for whom the services are performed has the right to control and direct the worker who performs the services. If a worker is subject to the will and control of the business -- not only as to what work shall be done, but also how it shall be done -- that worker is an employee. It is not necessary that the business actually controls how services are performed; it is sufficient if the business has the right to do so.

IRS Determination

If a person is not sure whether they are an employee or an independent contractor, he should obtain Form SS-8, *Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding*. Publication 15-A, *Employer's Supplemental Tax Guide*, provides additional information on independent contractor status.

Worker Classification Exercises

Exercise 1

A. Milton Manning, an experienced tile setter, orally agreed with a corporation to perform full-time services at construction sites. He uses his own tools and performs services in the order designated by the corporation, and according to its specifications of his work. The corporation pays him on a piecework basis and carries workers' compensation insurance for him. He does not have a place of business or hold himself out to perform similar services for others. Either party can end the services at any time.

Is Milton an employee or an independent contractor?

Answer

B. Steve Smith is laid off when Dunn Construction, Inc. downsizes. Dunn agrees to pay Steve a flat amount to complete one, part-time project to create a certain product. It is not clear how long it will take to complete the project, and Steve is not guaranteed any minimum payment for the hours spent on the program. Dunn provides Steve with no instructions beyond the specifications for the product itself. Steve and Dunn have a written contract, which provides that Steve is required to pay federal and state taxes and receives no benefits from Dunn.

Is Steve an independent contractor or an employee?

Answer

Exercise 2

John works at Steve's Plumbing. He is told to be at work Monday thru Friday, from 8 a.m. until 5 p.m. Steve observes the work John does, and has the right to provide direction.

Is John an independent contractor or an employee?

Answer:

Exercise 3

Craig owns "Craig's Construction." Craig buys all of his own tools, and sets his own work hours and fees.

Is Craig an independent contractor or an employee?

Answer:

Answers to Worker Classification Exercises

Exercise 1

A. Milton is considered an employee of the corporation.

B. Steve is considered an independent contractor.

Exercise 2

John is considered an employee.

Exercise 3

Craig is an independent contractor. Independent contractors may provide their services at several different locations. They are always in control of their hours, the fees they charge, and the tools they use.

CHAPTER VI
EMPLOYMENT TAXES

This chapter will introduce federal employment taxes. An employer is required to withhold federal income taxes from employee wages and report those amounts on federal employment tax returns. Your federal tax liability will be based upon your worker classification. The tax system is a pay-as-you-go system.

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 will need one if you:

- Have to pay employees,
- Are required to withhold taxes for non-wage payments,
- Have a self-employed retirement plan,
- Operate your business as a corporation or partnership or
- Are required to file employment tax returns.

How to Obtain an EIN

You can get an EIN by telephone or by mail. But first you must fill out Form SS-4, Application for Employer Identification Number. You can obtain a Form SS-4 at www.IRS.gov. It is also available by calling the IRS at 1-800-829-3676. For more information, refer to Publication 1635, *Understanding Your EIN*.

What Are My Federal Tax Responsibilities As An Employee?

As an employee, you will receive a Form W-2, *Wage and Tax Statement*, from each employer for whom you have worked during the year. Employers issue these forms in January of the following year. The form reflects the amount of wages paid to you and the federal and state taxes withheld and paid on your behalf throughout the year. Taxes are withheld based upon how you completed your Form W-4, *Employee's Withholding Allowance Certificate*. Tax withheld will differ depending upon the filing status you chose and the number of allowances you claimed. You should file an income tax return and report the wages shown on Forms W-2.

If the income reported from all Forms W-2 reaches certain minimum levels, the employee is required to file a federal income tax return for that year. Filing a return is the only way to obtain a refund of excessively withheld income.

What Are My Personal Federal Tax Responsibilities As An Independent Contractor (Self-Employed Individual)?

If you are self-employed, you are responsible for filing and paying all of your own taxes. These responsibilities include filing and paying both your federal income tax, self-employment tax, and employment taxes.

- Federal income tax is the tax on all income..
- Self-employment tax is comprised of 100% of your social security and Medicare taxes. Individuals who earn at least $400 in income as a sole proprietor, independent contractor, or partner are subject to self-employment tax. Individuals can offset their profits and losses from self-employment activities to determine the net income subject to tax.

NOTE: You may not owe federal income tax but may be liable for self-employment tax. If you are self-employed you may be required to make quarterly estimated tax payments based on your net income and any self-employment tax liability. For help in computing your estimated tax payment amounts, refer to Publication 505, *Tax Withholding and Estimated Tax*. You can make these payments electronically using EFTPS (refer to the discussion of EFTPS, later in this chapter).

Form 1099-MISC is required to be issued to any person (except a corporation) to whom you have paid over $600 for services rendered as an independent contractor during the year. If you have received over $600 from one person for services provided as an independent contractor, you should also receive Form 1099-MISC. If you do not, you are still required to report that income on your income tax return.

What Are My Federal Tax-Related Responsibilities If I Am An Employer?

You are required to obtain each employee's name and Social Security Number (SSN) and to enter them on Form W-2. This requirement also applies to resident and nonresident alien employees. You should ask your employee to show you his or her social security card.

An employee without a social security card can get one by completing Form SS-5, *Application for a Social Security Card*. This form can be found at Social Security Administration (SSA) offices; by calling 1-800-772-1213 or from the SSA web site at www.ssa.gov.

Employees need a SSN to be eligible for work in the United States. An Individual Taxpayer Identification Number (ITIN) is a tax processing number that is issued by the IRS for individuals who are required to have a U.S. taxpayer identification number but are not eligible to obtain one from Social Security. An ITIN is for federal tax purposes only and does not make a person eligible for employment. ***Do not accept an ITIN in place of a SSN for employee identification or for work.***

If you need to verify an employee's or potential employee's SSN, you have these options available:

- ***Telephone verification.*** You may verify up to five names and numbers by calling 1-800-772-6270. For up to 50 names and numbers, contact your local social security office.

- ***Large volume verification.*** The Enumeration Verification Service (EVS) may be used to verify more than 50 employee names and SSNs. Pre-registration is required for EVS or for more requests made on magnetic media. For more information, call the EVS information line (410) 965-7140, or visit www.ssa.gov/employer.

If you are an employer, in addition to their own personal tax obligations, you will have employment tax responsibilities. As an employer, you are responsible for all of the following:

- ***Form 941*** – This form is filed quarterly. This tax return shows the amounts that have been withheld and paid for employee's federal income tax, social security tax and Medicare tax. It will also include the amount paid by the employer for the employer's portion of social security tax and Medicare tax. You must deposit all income tax withheld, along with both the employer's and employee's share of Social Security and Medicare tax. For further information, refer to Publication 15, *Circular E - Employer's Tax Guide*.
- ***Form 940*** – This form is filed annually if you meet the filing requirements for Federal Unemployment Tax Act (FUTA). The tax is paid 100% by the employer. The form is issued to each employee, and reflects total wages, as well as federal and state taxes paid.
- ***Form W-2*** – This form is filed annually and issued to each employee. It reflects annual wages of the employees, as well as federal and state taxes withheld.

Can I Electronically File My Forms 940 and 941?

As a business owner, you have two options for electronically filing your employment tax returns:

1. You can go online and file electronically through an "Approved IRS e-file Provider," or
2. You may use a business tax professional who files employment tax returns and is able to file these forms electronically as an Electronic Returns Originator (ERO).

Advantages to e-filing

E-filing presents several advantages.

- It's paperless.
- You will receive an electronic acknowledgement within 48 hours.
- Tax preparation is automated with return preparation software that performs calculations and highlights needed forms and schedules.
- Forms 941 are accepted for the current quarter and for the four preceding quarters.
- The Form 940 is accepted for the current tax year.
- Integrated file and pay option business filers can e-file and, at the same time, pay the balance due electronically by authorizing an electronic funds withdrawal.

Business filers can e-file and, at the same time, pay the balance due electronically by authorizing an electronic funds withdrawal.

As An Employer, How Do I Deposit My Payroll Taxes?

In general, you must deposit income tax withheld and both the employer and employee social security and Medicare taxes (minus any advance Earned Income Credit payments) by mailing or delivering a check, money order, or cash to a financial institution that is an authorized depositary for federal taxes.

You may also elect to use the Electronic Federal Tax Payment System (EFTPS). This electronic service is offered free of charge, and it enables you to make and verify your federal tax payments electronically 24 hours a day, 7 days a week through the Internet or by telephone.

For more information, you may call 1-800-555-4477 or 1-800-945-8400. To enroll online, visit the website at www.eftps.gov. Once you enroll in EFTPS you can make ***ALL*** your federal business tax payments electronically, including income tax, estimated tax, and excise tax payments.

Penalties

Federal tax law requires filing accurate tax returns and paying taxes timely. If the required tax returns are not filed or if the required amount of tax is not paid, you may be charged penalties. Some of the penalties include:

- Failure to file
- Failure to pay
- Failure to deposit

The penalties will not apply if you can show that the failure was due to reasonable cause.

Note: Penalties and interest are assessed against your tax obligation. Penalties are not deductible on your tax return.

Employment Taxes and the Trust Fund Recovery Penalty

To encourage prompt payment of withheld income and employment taxes, including social security taxes, railroad retirement taxes, or collected excise taxes, Congress passed a law that provides for the Trust Fund Recovery Penalty (TFRP). These taxes are called trust fund taxes because you actually hold the employee's money in trust until you make a federal tax deposit in that amount. The TFRP may apply to you if these unpaid trust fund taxes cannot be immediately collected from the business. The business does not have to have stopped operating in order for the TFRP to be assessed.

Who Can Be Responsible for the Trust Fund Recovery Penalty?

The TFRP may be assessed against any person who:

- Is ***Responsible*** for collecting or paying withheld income and employment taxes, or for paying collected excise taxes, and
- ***Willfully*** fails to collect or pay them.

A *responsible* person is a person or group of people who has the duty to perform and the power to direct the collecting, accounting, and paying of trust fund taxes.

This person may be:

- an officer or an employee of a corporation,
- a member or employee of a partnership,
- a corporate director or shareholder,
- a member of a board of trustees of a nonprofit organization, and
- another person with authority and control over funds to direct their disbursement, or
- another corporation.

For *willfulness* to exist, the responsible person:

- must have been, or should have been aware of the outstanding taxes, and
- either intentionally disregarded the law or was plainly indifferent to its requirements. (No evil intent or bad motive is required.)

Using available funds to pay other creditors when the business is unable to pay the employment taxes is an indication of willfulness.

Responsibility is based on whether an individual exercised independent judgment with respect to the financial affairs of the business. An employee is not a responsible person if the employee's function was solely to pay the bills as directed by a superior, rather than to determine which creditors would or would not be paid. "*Notice 784, Could You Be Personally Liable for Certain Unpaid Federal Taxes?*" contains additional information regarding the TFRP.

Computing the TFRP Amount

The amount of the penalty is equal to the unpaid balance of the trust fund tax. The penalty is computed based on:

- The unpaid income taxes withheld, *plus*
- The employee's portion of the withheld FICA taxes.

For excise taxes, the penalty is based on the unpaid amount of collected excise taxes.

Caution: Once the Trust Fund Recovery Penalty is assessed, the IRS can take collection action against a responsible person's personal assets. For instance, IRS can file a federal tax lien or take levy, or seizure action.

Avoiding the TFRP

You can avoid the Trust Fund Recovery Penalty by making sure that all employment taxes are collected, accounted for, and paid to the IRS when required. Make your tax deposits and payments on time. Additional information on employment taxes can be found in Publication 15, *Employer's Quarterly Tax Guide*, and Form 941, Employer's *Quarterly Federal Tax Return*.

CHAPTER VII
ACCOUNTING METHODS

Definition

An accounting method is a set of rules to determine when and how income and expenses are reported. An accounting method clearly shows income when it treats all income and expenses the same from year to year and is appropriate for your line of work. Choosing the right accounting method is important because it will have an impact on when you report your income and when you deduct your expenses.

Choosing an Accounting Method

Generally, you choose an accounting method when you file your first tax return. Special rules govern the accounting methods for construction. Basically, accounting methods are divided into two categories; the cash method and the accrual method. There are several different accrual methods. Before choosing an accounting method, the following factors must be considered:

- The types of contracts you have,
- Your contracts' completion status at the end of your tax year, and
- Your average annual gross receipts.

Most construction businesses use two different tax accounting methods, one for long-term contracts and one overall method for everything else. A long-term contract is any contract that is not completed in the same year taxable year that it is started.

Categories of Accounting Methods

There are two basic accounting methods available to most small businesses. The cash method is one of the methods a construction contractor can use. Some construction contractors can use the cash method for long-term contracts as well as their overall general accounting method. The other method is the accrual method. This method allows you to include income when it is earned and report expenses when they are incurred.

Definition

Under the cash method, you report cash receipts as income when received (or constructively received) and deduct expenses when paid. The cash method is simpler and easier to maintain than the accrual method. A transaction is not recorded until the cash is received. However, under the cash method, if you extend credit to customers or you make purchases on credit, you could distort your income and expenses.

Constructively Received

Income may be actually or constructively received. If you received a check from a customer in Year 1 but did not deposit or cash it until Year 2, it is still included in income in Year 1, because that is the year you actually received it. Constructive receipt occurs when you have unrestricted access to income, including income you have earned.

Example 1

Johns Construction Company performs services for a customer. The customer calls in December and tells Mr. Johns the payment is ready for him to pick up, but he does not pick the payment up until January. He constructively received the payment in December.

If you could have received the money in one year, but chose not to receive it until a later year, it must be included in your income in the first year as if it had been actually received in that year. You cannot postpone including it in your income until the next year.

Who Cannot Use the Cash Method?

Some businesses are required to use the accrual method instead of the cash method. The following businesses cannot use the cash method of accounting:

- A corporation (other than an S corporation) with average annual gross receipts of more than $5 million,
- A partnership with a corporation (other than an S corporation) as a partner with average annual gross receipts of more than $5 million, and
- A tax shelter.

Exceptions

Certain businesses may use the cash method if they are any of the following:

- Generally, a family corporation with gross receipts of $25 million or less for each prior tax year beginning after 1985 (Refer to Publication 225, *Farmer's Tax Guide*, for more information),
- Any corporation or partnership that is not a tax shelter and has average gross receipts of less than $5 million over the 3 tax years ending with the prior tax year,
- A qualified personal service corporation, and
- A qualified small business meeting the small business exception rules.

Refer to Publication 538, *Accounting Periods and Methods*, for more information on the exceptions.

Definition

The accrual method requires you to report income in the year you earn it and expenses (including capitalized expenses) in the year you incur them. The purpose of an accrual method of accounting is to match income and expenses in the correct year.

Example 2

Wallace Construction completed a project in December of Year 1. They did not receive payment for services until February of Year 2. Wallace Construction will report the income in Year 1, because they must report the income in the year earned, and not in the year received. A cash basis business would have reported the income in Year 2.

Exercise 1

C. The following businesses are on an accrual basis; determine which year the income should be reported.

Henry's Construction completed a job in October of Year 1. The payment for services was received on November 15, Year 2.

Answer:

D. Brian and Doug Electrical finished a job on December 30, Year 2. They were paid on January 2, Year 3.

Answer:

NOTE: You may have received payments in advance for services rendered. Refer to Publication 538, *Accounting Periods and Methods*, for more information on how to handle these payments.

Inventory

Generally, if you produce, or sell merchandise in your business, you must keep an inventory. Inventory is necessary to clearly show income when the production or sale of merchandise is an income-producing factor. If you are required to account for inventory, you must generally use the accrual method of accounting for your purchases and sales.

Exception

There is an exception to the requirement to use the accrual method for inventory accounting. For inventory accounting, a business that produces purchases or sells merchandise may still be able to use the cash method of accounting. If you are required to keep an inventory, you may qualify to report the inventory under the cash method and continue to use the accrual method for the other portion of your business. In order for the exception to apply, you must be either a qualified taxpayer or a qualified small business taxpayer.

Qualified Taxpayer

To use the cash method instead of the accrual method of accounting for inventory, a qualified taxpayer must meet the gross receipts test for each prior tax year ending after December 16, 1998. For example, if you want to meet the exception for tax year 2000, you would use the gross receipts test for 1998 and 1999 tax years. To meet the exception for tax year 2002, you would use 1998, 1999, 2000 and 2001 tax years.

For each prior tax year, the average annual gross receipts must be $1,000,000 or less to be a qualified taxpayer. The average annual gross receipts are determined using a 3-year annual average for each prior tax year. If you were going to use the exception for 2002, the prior tax years are 1998, 1999, 2000 and 2001. The gross receipts average for 1998 would include tax years 1996, 1997 and 1998. The gross receipts average for 1999 would consist of 1997, 1998 and 1999. This would be done for each prior tax year through 2001.

Example 3

John has a plumbing business where he has inventory. He wants to know if he is a qualified taxpayer able to use the cash method for 2002. John's business is an S corporation and is not a tax shelter. John's annual gross receipts are the following for each tax year beginning with tax year 1996, $489,000; 1997, $625,000; 1998, $425,000; 1999, $632,000; 2000, $875,000; 2001, $1,110,000.

John will use prior tax years 1998, 1999, 2000 and 2001. His average annual gross receipts for 1998 are $513,000 ($489,000 (1996) + $625,000 (1997) + $425,000 (1998) =$1,539,000/3). For 1999, the average annual gross receipts is $560,667 ($625,000 (1997) + $425,000 (1998) + $632,000(1999) = $1,682,000/3). Average annual gross receipts for 2000 is $644,000 ($425,000 (1998) + $632,000 (1999) + $875,000 (2000) = $1,932,000/3). For the prior tax Year of 2001, the average annual gross receipts is $872,333 ($632,000 (1999) + $875,000 (2000) + $1,110,000 (2001) = $2,617,000/3).

John may use the cash method because his average annual gross receipts for each prior tax year ending after December 16, 1998, does not exceed $1,000,000.

Qualified Small Business Taxpayer

The other exception to using the cash method is a qualified small business. A qualified small business taxpayer must meet three requirements:

- Must be an eligible business,
- Must meet the gross receipts test for each prior tax year ending on or after December 31, 2000 (for each prior tax year, the average annual gross receipts

must be $10,000,000 or less, considering the three tax years ending with that prior tax year), and

- Must not otherwise be prohibited from using the cash method of accounting.

Eligible Qualified Small Business

In addition to meeting the requirements of a qualified small business, you must meet any of the conditions of an eligible business listed below.

1. Your principal business activity is not retailing, wholesaling, manufacturing, mining, publishing or sound recording determined by reference to the codes in the North American Industry Classification System (NAICS);
2. Your principal business activity is the provision of services, including the provision of property incident to those services; or
3. Your principal business activity is custom manufacturing.

NOTE: The business must not have previously changed (and was not required to change) from the cash method to an accrual method. For more information, refer to Publication 538, *Accounting Periods and Methods*.

Example 4

Marie's Electrical Corporation, which is an S corporation, has average gross receipts for 1998, 1999, 2000, and 2001 of $6,000,000, $8,000,000, $10,000,000, and $9,000,000. Marie's average annual gross receipts for the prior tax year ending 2000 are $8,000,000 ($6,000,000 + $8,000,000 + $10,000,000/3). For 2001, the average annual gross receipts are $9,000,000 ($8,000,000 + $10,000,000 + $9,000,000/3).

Marie may use the cash method of accounting.

Business Not Owned Or Not In Existence For 3 Years

If you did not own the business for all of the 3-tax-year period used in figuring your average, you may include the previous owner's annual gross receipts. If your business was not in existence for the 3-tax-year period, base your average on the period it has existed, including any short tax years, annualizing the short tax year's gross receipts.

Exercise 2

The following use the accrual method of accounting. Determine which of the following may use the cash method.

______A - Cook's Hardware Store sells construction supplies to local construction companies.

______B - Handy Construction Company began business several years ago. They purchased merchandise that is required to be kept in inventory. Hardy Construction's gross receipts for the following years were 1996, $435,000; 1997, $632,000; 1998, $678,000; 1999 $732,000; 2000, $800,000; 2001, $1,300,000.

______C - Miller Construction uses the accrual method of accounting. They want to know if they qualify for the cash method of accounting for 2002. Their gross receipts for 1998, 1999, 2000 and 2001 are respectively $7,000,000, $8,132,000, $11,200,000, and $13,000,000.

Not Keeping an Inventory

If you choose to use the cash method of accounting and you will not keep an inventory, you will deduct the cost of the merchandise in the year the merchandise is sold or paid for, whichever is later. If you are a producer, you can use any reasonable method to estimate the raw material in your work in process and finished goods on hand at the end of the year. This estimate is used to determine the raw material used to produce finished goods sold during the year.

Overview

In addition to the cash and accrual method of accounting, there are special accounting methods for the construction industry, such as the Completed Contract Method (CCM), the Percentage of Completion Method (PCM), and the Exempt-Contract Percentage of Completion Method (EPCM).

The Completed Contract Method (CCM)

Under the CCM, all the income from the contract and related job costs are reported in the year the project is completed and accepted by the customer. All contract revenue is deferred and the related costs are capitalized until the contract is complete. The completed contract method is probably the most common method that small contractors use because of the deferred tax benefit.

Example 5

Craig uses the CCM.

- In June of Year 1, he contracted with Murphy to build a restaurant of $500,000.
- The estimated total costs for the contract were $400,000.
- On March 31 of Year 2, the contract was completed and Murphy accepted the building.

As of December 31 of Year 1, Craig had $370,000 of actual job costs tied to the contract. From January 1 to March 31 of Year 2, he incurred another $30,000 of actual job costs on the restaurant. Total job costs from the project are $400,000.

Craig's income and job costs from other contracts in Year 1 and Year 2 were as follows:

	Year 1	Year 2
Income	$750,000	$300,000
Job Costs	$525,000	$225,000
G&A Costs	$75,000	$85,000

Under CCM, Craig must capitalize all the job costs related to the restaurant contract and wait to deduct them until the job is completed and the income is reported, in Year 2.

In Year 1 and Year 2, Craig will report:

	Year 1	Year 2
Income	$750,000.00	$800,000.00
Job Costs	($525,000.00)	($625,000.00)
G&A Costs	($75,000)	($85,000)
Net Income	$150,000.00	$90,000.00

Income in Year 1 only includes the other contracts income (refer to table above). The project income will be reported when complete, which is Year 2. The contract price was $500,000. Add to it the other contracts $300,000 (refer to table above) and the income for Year 2 is $800,000.

The Job Costs of $525,000 in Year 1 is from other contracts only. The costs related to the projects will be reported in Year 2, along with Year 2's other contracts. The $625,000 of Job Costs in Year 2 consists of $400,000 of the projects costs and $225,000 of job costs for other contracts.

Exercise 3

Contractors, Inc. constructed a building for Financial Associates pursuant to a long-term contract executed in 1999. The gross contract price was $2.5 million, which was paid in quarterly payments over the term of the contract. Contractors, Inc., completed construction in 2001, having expended $600,000 in the first year, $700,000 in the second year, and $600,000 in the third year, for a total cost of $1.9 million. If Contractors Inc. used the CCM, in what year would they report the profit from the contract?

Answer:

The Percentage of Completion Method (PCM)

The PCM requires that income be reported in proportion to the percentage of costs incurred to date, when compared to total estimated costs for the contract. A percentage of the income is recognized to match the expenses incurred on the contract during the duration of the contract. IRC Section 460(a) requires the use of the PCM for long-term contracts. The formula for determining current year income under the most common PCM (called the “cost to cost,” or “cost comparison” method) is:

$$\frac{\text{Total Costs Incurred to Date}}{\text{Total Estimated Cost of Job}} \times \text{Total Estimated Contract Price} - \text{Prior Year's Income} = \text{Current Year Income}$$

Example 6 (PCM Cost Comparison Method)

Hardee Construction, Inc. entered into a 3-year contract to build an office park. The total contract price was $1,000,000. The cumulative costs for the three years were $200,000 (Year 1), $600,000 (Year 2) and $750,000 (year 3). The estimated total cost for the project changed each year under the contract. For Year 1, the estimated cost was $800,000; for Year 2, $900,000; and for Year 3, $750,000. If Hardee Construction, Inc. used the PCM, the current year gross receipts would be reported as follows:

Total Contract Price: $1,000,000	Year 1	Year 2	Year 3
Cumulative Costs	$200,000.00	$600,000.00	$750,000.00
Estimated Total Costs	$800,000.00	$900,000.00	$750,000.00
Completion Factor	25%	67%	100%
Cumulative Gross Receipts (CGR)	$250,000	$670,000	$1,000,000
Prior Year CGR	0	($250,000)	($670,000)
Current Year Gross Receipts	$250,000	$420,000	$330,000

Exercise 4

USA Builders, Inc. entered into a 3-year contract to build an office building. The total contract price was $1,500,000. The cumulative costs for the three years were $250,000 (Year 1), $400,000 (Year 2), and $1,200,000 (Year 3). For Year 1, the estimated cost was $900,000; for Year 2, $950,000; and for Year 3, $1,200,000. If USA Builders, Inc. used the PCM, what would be the current year gross receipts reported in each of the three years?

Year 1______

Year 2______

Year 3______

Exempt-Contract Percentage of Completion Method (ECPCM)

An exempt contract method is a method of accounting for long-term contracts that is exempt from the requirements of section 460(a). A taxpayer using the EPCM must still include in income the portion of the total contract price that corresponds to the percentage of the entire contract that the taxpayer has completed during the tax year. However, under the exempt percentage of completion method, the percentage of completion may be determined by using any method of cost comparison, such as comparing direct labor costs incurred to date to estimated total direct labor costs. The percentage can also be determined by comparing the work performed on the contract with the estimated total work to be performed, rather than by using the usual cost-to-cost comparison, provided the method is used consistently and clearly reflects income.

The formula for determining gross income on the basis of a comparison of work performed is:

$$\text{Expected Contract Price} \times \frac{\text{Work Performed (as of the end of year)}}{\text{Estimated Total Work}} - \text{Amounts of Price Reported In Income For Prior Years} = \text{Gross Income}$$

An architect or engineer must certify the percentage of work completed.

Exercise 5

Kyle Barkley's Construction Company entered into a contract to build a fishing pier. The expected contract price was $1,300,000. The work performed as of the end of the first year totaled 1,920 hours. The work performed as of the end of the second year totaled 3,000 hours. Mr. Barkley, the owner, estimates that the total number of hours needed to complete the project is 4,500. Under the exempt-contract percentage method, what is the gross income to be reported in each of the first two years of the contract?

Answer:

In determining the allowable accounting method to use, there are several categorizations that must first be addressed. Only certain accounting methods are allowed for a specific set of contract factors. Combinations of factors, such as whether the contract is long or short-term, the contract is a home construction or general construction contract, and the contractor is a small or large contractor, play a crucial role in determining the correct methods to use. The following contracts will be discussed in the remaining part of this course:

A. Short or Long-Term Contracts:
   - Short-Term Use Contracts (Overall Method)
   - Long-Term Contracts
B. Long-Term Contracts:
   - Home Construction Contracts
   - General Construction Contracts
C. General Construction Contracts:
   - Large Contractors
   - Small Contractors (Complete Work)

D. Small Contractors:
- Contracts Within Two Years (Accrual, CCM)
- Contracts Longer Than Two Years

Long and Short-term Contracts

A long-term contract is any contract that spans a taxable year-end. If you use a calendar tax year and have a contract that you start on December 26th, but do not complete until January 23rd, you have a long-term contract. A short-term contract is any contract you start and finish within one taxable year.

Use your overall method (i.e., accrual or cash, if allowed) for your short-term contracts. You must then choose an accounting method for all your long-term contracts.

Exercise 6

Jet Construction, Inc. entered into a contract on June 1, 2003. The contract was completed March 31, 2004, lasting only 10 months. If Jet Construction is on a calendar year, is the contract a long- or short-term contract?

Answer

Home Construction vs. General Construction

The first step in determining the correct method to use for a long-term contract is to identify the contract as either a Home Construction Contract or a General Construction Contract. Home Construction Contracts are contracts for work on buildings that have four or fewer residential units. Eighty percent or more of the estimated total contract costs must be for the construction, improvement, or rehabilitation of these units. If a contract is not a home construction contract, it is a general construction contract.

Example 7

Contracts to build single-family homes, duplexes, triplexes, or quadplexes would be home construction contracts. Contracts to build apartment buildings would not be home construction contracts.

Small and Large Contractors

In order to determine if you are a small or large contractor, you must measure your average annual gross receipts for the last three tax years of your construction business. In general, if the amount is $10 million or less, you are a small contractor. If it is more than $10 million, you are a large contractor.

Home Construction Contracts

Your choice of methods of accounting for income and expenses for home construction projects depends on land ownership and whether you are a small or large contractor. Your accounting method controls which costs are allocated to your projects.

Some of the available methods used for home construction contracts include the Spec Home Rules, the Completed Contract Method (CCM), and the Percentage of Completion Method (PCM). Each of the available methods includes specific indirect job costs that must be allocated among the home construction projects benefited.

Spec Home Rules

When you build a "speculation," or spec home, you are creating an asset that will be sold to another person. Spec homes are built in anticipation of a sale; therefore, a construction contract does not exist. You do not use the rules for home construction contracts, which are contracts to build a home with four or fewer residential units.

When you build a spec home, all the direct and indirect costs are accumulated. These costs are called the basis of the property, and cannot be deducted until the home is sold. The costs that must be included in the basis of the home are the cost for:

- Land,
- Materials,
- Labor, and
- Allocated indirect costs.

Thus, the income is reported and the basis is deducted in the year the home is sold. The main difference between the Spec Home Rules and the Completed Contract Method is the type of indirect costs that can be allocated under each method. Certain indirect costs allocated under the Spec Home Rules cannot be allocated under CCM. Please refer to Accounting for Construction Contracts-Construction Tax Tips on the IRS web site for more information.

Exercise 7

Is the construction of a spec home considered to be under a construction contract? Yes or No.

____

Answer:

Custom Home Built on Builder's Land

A custom home built on land owned by the contractor is built under a construction contract because the home must be built to fulfill the contract with the buyer. As with spec homes, you accumulate the costs of the home and postpone the deduction of the basis until the contract is completed. If you are a large contractor, you must use the

Spec Home Rules. If you are a small contractor, you must use the Completed Contract Method, which was discussed earlier.

Title does not transfer until settlement, therefore, income is reported and basis is deducted at settlement. For both available methods, Spec Home Rules and the Completed Contract Method, all the direct and indirect costs are accumulated.

Custom Home Built on Buyer's Land

A custom home built on land owned by the buyer is also built under a construction contract, because the home must be built to fulfill the contract with the buyer. Title to the work transfers as it is performed. Homebuilders usually receive advance payments, and may use accrual, PCM, or CCM.

- If you use accrual, you will report income when you are entitled to receive it and will deduct expenses when they are incurred. If you use PCM, then your direct and indirect job costs are used to compute the income from the contract, and all the costs are currently deductible.
- If you use CCM, any income received under the contract is deferred until the contract is completed. All costs related to the contract are also deferred until closing. The basis is then deducted, and all net income reported.

Land Developers

A developer acquires land, obtains approval, secures construction financing, and begins construction of residential developments in stages or phases.

The developer assigns all the direct job costs and an allocated portion of the indirect job costs and the common improvements to each lot in the development. Common improvements include such things as streets, curbs, sidewalks and sewers. These costs must be matched with the sales price of each lot as it is sold.

Large Contractors

As stated above, if your construction business has average annual gross receipts for the last three tax years of $10 million or less, you are a small contractor. If it is more than $10 million, you are a large contractor.

In addition to the accrual method, large contractors can use PCM (both the cost comparison method and the simplified cost comparison method).

The Look-Back Interest Computation

The Look-Back Interest Computation for Large Contractors requires in some cases that the income be recomputed. If the contract price and/or the total job costs have changed over the life of the contract, you must make this Look-Back computation in the year the contract is completed.

The income from the contract must be recomputed in all years based on the final contract price and the actual costs. You do not file amended returns for the prior years. You just use the information from those years to compute the Look-Back Interest for the completion year. If the look-back taxable income is less than what was reported, you get a refund of interest on the overpayment of tax. If the look-back taxable income is more than previously reported, then you pay interest on the underpayment of tax.

IRS Form 8697, *Interest Computation Under the Look-Back Method for Completed Long-Term Contract*s, is filed with your income tax return for the completion year, if you owe Look-Back Interest to the IRS. If the IRS owes you Look-Back Interest, you file the form separately with the IRS Service Center where your income tax is required to be filed.

Small Contractors

If you are a small contractor, you should separate your long-term general construction contracts into two categories. The first category is those contracts that are reasonably likely to be completed within two years from the date work starts.

Small contractors that complete work within a two-year period can use the accrual method, the CCM, the PCM, the EPCM, or the cash method (unless accrual is required).

The second category is long-term general construction contracts that you estimate will take two years or more to complete. For these longer-duration contracts, you must use a large contractor method, even though you are a small contractor. Small contractors with construction contracts over 2 years in duration should use the PCM for all of those contracts.

Example 8

Carl's Construction had average annual gross receipts for the last three tax years of less than $10 million. In 2000, Carl had 20 contracts.

At the time he entered 19 of the contracts, he estimated they could be completed in less than two years from when they are started. He estimated one of the contracts would take three years to complete. Carl will use the large contractor rules for that one contract and the small contractor rules for the other 19 contracts.

Example 9

Use the same facts as the last example, except assume Carl's Construction had average annual gross receipts of $12 million for the last three tax years. Since his average annual gross receipts for the last three years were over $10 million, Carl is required to use the large contractor rules for all of his contracts. The estimated completion time of the contracts does not matter.

Overview

The two basic categories of costs your construction business will have are job costs and general and administrative (G&A) costs.

Job Costs are the expenses related, either directly or indirectly, to the construction job, like construction wages, materials, and allocated indirect costs. G&A Expenses are the day-to-day expenses of running the business, like office expenses and utilities. However, certain administrative costs are sometimes treated like indirect job costs to figure the income earned on a contract.

General and Administrative Expenses

General and Administrative (G&A) expenses are indirect costs of operating a construction business that cannot be traced to specific jobs. However, certain administrative costs may be treated like indirect job costs.

For example, the wage paid to the person in the office who keeps track of the costs for each job is a G&A type expense that would be treated as indirect job cost. On the other hand, selling and advertising costs are G&A expenses that would not be treated like indirect job costs. Generally, G&A expenses will be deductible under the accrual rules.

Job Costs

Job costs are divided into two groups, direct and indirect. Direct job costs such as labor, materials and subcontractor expenses can be traced directly to the construction project. The wage paid to a site manger is an example of a direct labor cost. Similarly, direct materials would include lumber for framing a house or concrete for the foundation of a shopping center.

Direct costs also include amounts paid to subcontractors. Subcontractors work for and are paid by the general contractor on a project. Subcontractors may also provide the raw materials for the job. Labor and materials provided by a subcontractor are generally treated as direct costs.

Indirect job costs are all the costs necessary for the performance of the contract other than direct materials, direct labor and subcontractors. The expenses included in indirect job costs differ depending on whether you are a small or large contractor.

Allocating Indirect Costs

You have learned that indirect job costs benefit the project but are not tied as clearly to it as direct costs are. Indirect job costs often involve expenses that benefit more than one job and must be allocated among all the jobs that received benefit.

Example 10

Norm started three different jobs in 2000. None of the jobs were completed by the end of 2000. He spent six months on the first job, four months on the second job, and two months on the third job.

He had $12,000 of indirect costs to be allocated to the three jobs. Norm would allocate the indirect costs as:

FIRST JOB: 6 mo./12 mo. X $12,000 = $6,000 Allocated Indirect Costs

SECOND JOB: 4 mo./ 12 mo. X $12,000 = $4,000 Allocated Indirect Costs

THIRD JOB: 2 mo./12 mo. X $12,000 = $2,000 Allocated Indirect Costs

Exercise 8

John started four different jobs in 2002. None of the jobs were completed by the end of 2002. He spent two months on the first job, four months on the second job, three months on the third job, and three months on the fourth job.

Answer:

Indirect Job Costs for Small Contractors

Indirect Job Costs for Small Contractors consist of the following:

- Repair & maintenance expenses for equipment & facilities,
- Utilities,
- Rent of equipment & facilities,
- Quality control,
- Taxes relating to labor, materials, supplies, equipment or facilities,
- Administrative costs,
- Indirect materials and supplies,
- Tools & Equipment,
- Depreciation,
- Insurance on equipment & machinery,
- Indirect labor and contract supervisory wages, and
- Production period interest expense.

Exercise 9

Please indicate whether a cost item is a direct cost (D) or indirect cost (I).

A ____ Pay to subcontractors
B ____ Depreciation
C ____ Insurance on equipment
D ____ Lumber for framing
E ____ Tools
F ____ Wages paid to site manager
G ____ Concrete for foundation
H ____ Utilities

Indirect Job Costs for Large Contractors

The importance of this list is to show what costs, in addition to materials, labor and subcontractor costs are used to compute income. As you can see, a large contractor is required to include more costs in the PCM computation than a small contractor.

Indirect Job Costs for Large Contractors consist of the following:

- Repair and maintenance of equipment and facilities,
- Utilities,
- Rent of equipment and facilities,
- Indirect labor and contract supervisory wages,
- Indirect materials and supplies,
- Tools and equipment not capitalized,
- Quality control and inspection,
- Taxes on labor, materials, supplies, equipment or facilities,
- Depreciation,
- Administrative costs,
- Insurance,
- Officer's compensation (corporation),
- Contribution to stock bonus, pension/profit-sharing, deferred compensation and other employee benefit expenses,
- Research and experimental,
- Rework labor, scrap and spoilage,
- Successful bidding expenses, and
- Production period interest expense.

Overview

If you want to change your accounting method, you must get IRS approval. A change in your accounting method includes a change not only in your overall system of accounting but also in the treatment of any material item. A material item is one that affects the proper time for inclusion of income or allowance of a deduction.

Form 3115

Once you have chosen your accounting method, advance IRS approval is generally required if you want to change your accounting method. To get approval, you must file Form 3115, *Application for Change in Accounting Method*, during the tax year for which the change is requested.

If you are using an incorrect accounting method, it is to your advantage to change it before IRS contacts you for an examination. For additional information, refer to Revenue Procedure 97-37. More stringent requirements apply for taxpayers wishing to change their accounting method during an examination.

In many situations advance IRS approval is ***not*** required to change your accounting method. However, Form 3115 is still required. You should file as early in the year as possible to give IRS enough time to respond to the form before the original due date of the return for the year of change. If you do not file a Form 3115 during the year of change, an extension to file the form will be granted only in unusual and compelling circumstances.

Automatic Accounting Method Changes

These are procedures under which certain taxpayers can presume to have IRS approval to change their method of accounting. The approval is granted for the tax year for which the taxpayer requests a change (year of change), if the taxpayer complies with the provisions of the automatic change procedures. No user fee is required for an application filed under an automatic change procedure. Generally, you must use Form 3115 to request an automatic change.

Several Revenue Procedures contain information on automatic accounting method changes. It is very important to read the entire revenue procedure after determining that a particular accounting method change applies to you.

- Revenue Procedure 2001-10 allows taxpayers with annual gross receipts under $1,000,000 who were required to use the accrual method of accounting because they have inventory, to change to the cash method of accounting without advance permission from the IRS.
- Revenue Procedure 99-49 describes several accounting method changes that no longer require advance permission from the IRS: (note: Form 3115 is still required).

More Information

For more information on a change in accounting method, please refer to Publication 538, *Accounting Periods and Methods*, the Form 3115 Instructions, and Revenue Procedure 97-27.

Summary

There are many special accounting methods used in the construction industry. The proper accounting method you should use depends on a combination of factors, such as whether the contract is a long or short-term contract, whether the contract is, a home construction contract or general construction contract, and whether the contractor is a small or large contractor. Job costs, indirect and direct, as well as general and administrative expenses, must also be taken into consideration.

Answers to Exercises

Exercise 1

A. Year 1

B. Year 2

Exercise 2

C. No. Cook Hardware sells retail.

D. Yes. Handy Construction average gross receipts are less than $1,000.000.

1998 ($435,000 + $632,000 + $678,000)/3 = $581,666.67
1999 ($632,000 + $678,000 + $ 732,000)/3 = $680,666.67
2000 ($678,000 + $732,000 + $ 800,000)/3 = $736,666.67
2001 ($732,000 + $800,000 + $1,300,000)/3 = $944,000.00

E. No. The average gross receipts are more than $10,000.00.

Exercise 3

2001

Exercise 4

Total Contract Price: $1,000,000	Year 1	Year 2	Year 3
Cumulative Costs	$250,000	$400,000	$1,200,000
Estimated Total Costs	$900,000	$950,000	$1,200,000
Completion Factor	28%	42%	100%
Cumulative Gross Receipts (CGR)	$420,000	$630,000	$1,500,000
Prior Year CGR	0	($420,000)	($630,000)
Current Year Gross Receipts	$420,000	$210,000	$870,000

Exercise 5

Year 1: $1,300,000 X (1,920/4,500) – 0 = $554,666.67

Year 2: $1,300,000 X (3,000/4,500) – $554,666.67 = $312,000.00

Exercise 6

Jet Construction has a long-term contract, since the contract was not started and completed in the same year.

Exercise 7

No

Exercise 8

FIRST JOB: (2 mo. /12 mo.) X $20,000 = $3,333.33 Allocated Indirect Costs

SECOND JOB: (4 mo. /12 mo.) X $20,000 = $6,666.67 Allocated Indirect Costs

THIRD JOB: (3 mo. /12 mo.) X $20,000 = $5,000 Allocated Indirect Costs

FOURTH JOB: (3 mo. /12 mo.) X $20,000 = $5,000 Allocated Indirect Costs

Exercise 9

A. *D* Pay to subcontractors
B. *I* Depreciation
C. *I* Insurance on equipment
D. *D* Lumber for framing
E. *I* Tools
F. *D* Wages paid to site manager
G. *D* Concrete for foundation
H. *I* Utilities

CHAPTER VIII
ELECTRONIC FILING AND PAYING

In the 21st Century, you can run your entire business electronically. So why not file and pay your business taxes the same way? Now business taxpayers can file and pay by telephone, by Internet, or by computer. It is more economical, with less paperwork. It is more efficient, with increased accuracy. And it is more effective, with more time to focus on your business and less time spent filing tax returns and making payments.

You will find that most small business filing requirements can be submitted electronically. For example:

- Self-employed income tax returns (Form 1040, Schedules C, E and F),
- Partnership income tax returns (Form 1065 and most related forms),
- Employment tax returns (Forms 940/941),
- Certain information returns (e.g., Forms 1098, 1099, W2-G), using the Filing Information Returns Electronically (FIRE) system, and
- Income tax returns for Estates and Trusts (Form 1041).

Some Advantages of Going Totally Electronic

- ***Increased accuracy:*** IRS computers quickly and automatically check for errors or missing information, making e-file returns more accurate and reducing the chance of receiving a letter from the IRS.
- ***Quick electronic confirmation:*** E-filers receive an acknowledgment that the IRS has received their returns. Callers using TeleFile receive a confirmation number while they are still on the telephone, letting them know that the TeleFile System has accepted their return.
- ***Deletion of paperwork through electronic signatures:*** You can create your own Personal Identification Number (PIN) and file a completely paperless return using a personal computer or tax professional. You have nothing to mail to the IRS.
- ***Easy payment options:*** With Electronic Federal Tax Payment System (EFTPS) you can make your payments from the convenience of your office or home, 24 hours a day, seven days a week, using the Internet, EFTPS computer software, or the telephone. One must enroll in EFTPS to use the system.

e-file for Business

Whether you are a business, big or small, you will find an e-file for Business filing option that meets your needs. IRS e-file is available for:

- Employment taxes,
- Information returns,
- Partnerships,
- Estates,
- Trusts,
- Corporations, and
- Exempt organizations.

Employment Taxes

The IRS Employment Tax e-file program offers businesses a variety of ***paperless*** options for filing Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, and Form 941, Employer's Quarterly Federal Tax Return. Using this program, businesses, reporting agents, software developers, and transmitters can file Form 940 and Form 941 electronically. The program conducts security checks, builds records to be processed by IRS computer systems, and sends electronic acknowledgments. Returns are transmitted nationwide, via dial-up phone lines and menu driven software, directly to the IRS, where they are processed at the Tennessee Computing Center (TCC)/Memphis Submission Processing Center (MSPC).

If you use a tax professional to prepare your business returns, be sure to ask him/her about e-file for Business and electronic payment options.

IRS e-file for Business Partners are companies and providers the IRS has entered into cooperative marketing agreements with to bring you special offers and discounts for using e-file for Business products and services. The listing of Approved IRS e-file for Business Providers contains addresses and telephone numbers including links to their web sites.

Partnerships

Section 1224 of the Taxpayer Relief Act of 1997, requires partnerships with more than 100 partners (Schedules K-1) to file their return on magnetic media (electronically, as prescribed by the IRS Commissioner). This law became effective for partnership returns with taxable years ending on or after December 31, 2000. Partnerships with 100 or less partners (Schedules K-1) may voluntarily file their return electronically.

The current 1065 e-file program does not accept and process all partnership return types. Refer to Publication 1524, Procedures for the 1065 e-file Program, for additional information.

Filing Information Returns Electronically (FIRE)

Electronic filing of information returns allows you to submit:

- Form 1042S, Foreign Person's U.S. Source Income Subject to Withholding
- Form 1098, Mortgage Interest Statement
- Forms 1099 (All)
- Form 5498, IRA Contribution Information
- Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips
- Form W-2G, Certain Gambling Winnings
- Questionable Form W-4 (QWF)

These returns are filed using the Internet. Requests for extensions of time to file can also be submitted electronically for all of these forms, except for the Questionable Form W-4 and Form 8027.

The FIRE System allows high-speed transmissions and offers non-peak telephone hours. The system is operational ***24 hours a day, seven days a week***.

If you are required to file 250 or more information returns, you must file electronically or magnetically. The 250-or-more requirement applies separately to each type of form.

For example, if you need to file 500 Forms 1098 and 100 Forms 1099-A, you must file Forms 1098 electronically or magnetically, but not Forms 1099-A. The electronic/magnetic media filing requirement does not apply if you request and receive a hardship waiver.

TIP: The IRS encourages you to file electronically or magnetically even though you are filing fewer than 250 returns.

The format requirements for filing information returns electronically are the same as the requirements for filing on magnetic media. If you are unable to prepare the files yourself and want to purchase software or locate someone to file on your behalf, refer to Publication 1582, *Information Returns Vendor List*. Publication 1582 is for information only and in no way implies IRS approval or endorsement of products or services. You may also check your telephone directory for service bureaus.

For further information refer to Publication 1220, *Specifications for Filing Forms 1098, 1099, 5498 and W-2G Magnetically or Electronically* or Publication 1187, *Specifications for Filing Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding*.

Electronic Federal Tax Payment System

Electronic Federal Tax Payment System (EFTPS) is a tax payment system offered for free from the U.S. Department of Treasury. All federal taxes, including income, employment, estimated, and excise taxes, can be paid electronically on-line or by phone 24 hours a day, seven days a week. Visit www.EFTPS.gov to enroll.

More than four million taxpayers are currently using the system. EFTPS is:

- Fast and economical,
- Easy to use,
- Convenient,
- Accurate, and
- Flexible.

Convenience at Your Fingertips

EFTPS offers you the convenience and flexibility of making your tax payments through the Internet or by telephone. You can select how you want to make your payments. There are two primary payment methods, EFTPS-Direct and EFTPS-Through a Financial Institution. You may also use the Same Day payment method offered by some financial institutions.

EFTPS-Direct is an electronic payment method that allows you to access EFTPS directly to make your tax payments. You instruct EFTPS to move the funds from your bank account to the Treasury's account on the date you indicate. Funds will not move from your bank account until the designated day. The two payment methods under EFTPS-Direct are EFTPS-OnLine (Internet) and EFTPS-Phone. With EFTPS-Direct both methods are interchangeable.

If you elect to use EFTPS-Through a Financial Institution, you will instruct your financial institution to electronically move funds from your bank account to the Treasury's account. Check with your financial institution to find out if they offer this service, how much it costs, and if you are eligible to use it.

You can also pay your quarterly estimated taxes electronically using EFTPS. Payments can be made weekly, monthly, or quarterly, as well as scheduled for an entire year in advance.

You can initiate your tax payment 24 hours a day, seven days a week. As an added convenience, EFTPS-Direct allows payment scheduling to warehouse your tax payments. Businesses can schedule payments up to 120 days in advance of their tax due date. Individuals can schedule payments up to 365 days in advance of their tax due date. EFTPS will automatically make your payments for you on the due date you indicate.

EFTPS Enrollment

To participate in EFTPS, you must first enroll. There are two ways to enroll in the program: enroll online at http://www.EFTPS.gov or complete Form 9779, Business Enrollment Form and mail it to the EFTPS Enrollment Center. To receive an enrollment form call

1-800-555-4477 or 1-800-945-8400

1-800-945-8900 or 1-800-733-4829 (TDD Hearing-Impaired)

1-800-945-8600 or 1-800-244-4829 (Español)

It takes only minutes to make a tax payment using EFTPS-Direct. It is much less burdensome than writing checks, getting signatures on checks, and making last minute trips to the bank. You will receive an EFT Acknowledgement number to keep as a record of your tax payment.

Whether you use EFTPS-Direct or EFTPS-Through a Financial Institution, you are in control of initiating your payments. Your tax due date remains the same and no government agency has access to your account.

You can use in EFTPS-OnLine to make a payment, cancel a payment, review your payment history, and more. It is easy to navigate and is secure, with both a PIN and Internet Password combination.

To find out more about IRS e-services, visit www.IRS.gov. By clicking on the e-file logo, more information can be found on filing your tax returns electronically. You will also find a listing of Approved IRS e-file for Business Providers. By clicking on the EFTPS logo, you can obtain more information about EFTPS.

File Smart…File Electronic

"The fast and accurate way to file (www.IRS.gov),
and pay (www.eftps.gov) your federal taxes."