

**TAX PREPARATION TIPS & TRICKS**

# **TAXES FOR HOMESCHOOL BUSINESS OWNERS**

**BY CAROL TOPP, CPA**



# Taxes for Homeschool Business Owners

FOR TUTORS, TEACHERS, AND DIRECTORS OF HOMESCHOOL  
PROGRAMS

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*Dedicated to homeschool leaders of all kinds. You are my heroes.*

*Also dedicated to the generous people at the Let Us Reason for Real Facebook group who strive to educate and inform homeschool business owners, sometimes at great personal risk.*

# Introduction

Many homeschool business owners tell me they cannot afford to pay for a CPA or attorney and so they put themselves at great risk of making costly mistakes.

This book is an attempt to get basic but accurate business and tax information into the hands of homeschool business owners. I have always striven to give helpful, correct information to homeschool leaders via my website, HomeschoolCPA.com. I care deeply about homeschooling (I homeschooled for 14 years) and want the movement to continue with good, legal practices.

I am offering this book so that homeschool business owners will stay out of trouble with the IRS.

I hope it is helpful to you.

Carol Topp, CPA

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# Chapter 1: Business Start-Up

Welcome! I hope this book is helpful in running your homeschool business and understanding your tax situation. Let's start with determining what type of business you are running. The type of business you operate determines what tax forms you file and what expenses you can deduct.

## Three Types of Businesses Structures

In the United States, there are three different business structures:

- sole proprietorship
- partnership
- corporation

There are also nonprofit organizations that can be either nonprofit corporations or unincorporated associations. I explain nonprofit organizations in Chapter 10 "Should My Homeschool Program be a Nonprofit?" Most homeschool programs are organized and operated as nonprofit organizations, but they can also be a for-profit business. The vast majority of homeschool for-profit businesses are sole proprietorships. This book will address sole proprietorships, since that is the most common business type for homeschool programs.

## Why a Sole Proprietorship?

There are so many reasons to choose sole proprietorship (meaning there is only one owner of the business) as your business model. Eighty percent of American businesses are sole proprietorships and here's why:

- Quick to start—You are open for business as soon as you say that you are or at least when you collect your first payments from customers.
- Easy to close—A sole proprietorship closes down when the owner decides to close and ceases to operate.
- Easy to understand—You probably know someone who operates a small business as a sole proprietorship and can understand what they do. On the other hand, partnerships and corporations can be very complex and difficult to understand.

- No lawyer is needed to start a sole proprietorship—Many sole proprietorships are formed without the assistance of a lawyer. I strongly recommend hiring an attorney if you are forming a partnership or corporation or if you are signing any type of contract or licensing agreement.
- Simple tax structure—A sole proprietor uses a two-page form (Schedule C Business Income or Loss) as part of their personal tax return (the Form 1040). Partnerships and corporations require separate multi-page tax returns *and* additional forms that are added to the owners' personal tax returns.
- Simplified record keeping—Like any business, a sole proprietorship needs to keep good records, but bookkeeping can be simple. Many sole proprietors can do their own bookkeeping. They may hire an accountant for an initial consultation or for tax preparation. I am happy to offer a business consultation by phone. You can contact me at [HomeschoolCPA.com](http://HomeschoolCPA.com).
- You keep the profits—Partnerships and corporations distribute their profits to partners or shareholders, but a sole proprietorship business owner keeps all the profit for herself.
- No investors to satisfy—As a sole proprietor, you, the owner, need to be happy with the business progress, not outside investors or partners.

### Three Important Start-Up Tasks

The three most important tasks any sole proprietor needs to do when starting a business include picking a business name, getting an Employer Identification Number (EIN), and opening a business checking account.

#### 1. Pick a Business Name

Legally, a sole proprietor can use his or her own name as the business name. However, if you use any name other than your personal name, you must register that name with your local or state government. This business name is usually called a DBA (Doing Business As) name. Since rules vary by state and county, you should visit <http://dbafilingonline.com/dba-by-state/> or do an internet search using your state's name and "business registration" or "fictitious business name." Your search should lead to the regulations and proper forms for your state, usually at your state's Secretary of State website.

I ran my accounting practice using only my name, Carol Topp, CPA for many years. It was easy. That name was on my business cards and checking account. No fictitious name registration was needed. Then I created a publishing company, Ambassador Publishing, and started doing business under its name. I registered that name with Ohio's Secretary of State. I filled out a one-page document and paid a \$50 fee. My bank asked for a copy of my DBA paperwork from the state of Ohio so that I can legally deposit checks made out to Ambassador Publishing into my Carol Topp, CPA checking account.

#### 2. Get an Employer Identification Number

Some sole proprietors use their Social Security Number (SSN) as their identification on any income tax and payroll tax forms. Since identity theft is pervasive, I recommend you obtain an Employer Identification Number (EIN) from the Internal Revenue Service to keep your Social Security Number private.

An EIN is like a Social Security Number for businesses. You can receive the number from the IRS online in minutes at no cost. Go to [www.IRS.gov](http://www.IRS.gov) and type "EIN" in the search box. Before you do this, I recommend that you look at IRS Form SS-4 (find it at [IRS.gov](http://IRS.gov)) so you know what information the IRS will request.

The IRS will only issue one EIN to a sole proprietorship, even if he or she opens several businesses with different names. So, do not use your businesses name (i.e., your DBA name) when applying for an EIN. Use only your legal, personal name. The same EIN will be used for any and all businesses that you start as a sole proprietorship, even if they have different business names.

### 3. Open a Business Checking Account

I always advise sole proprietorships to open a separate business checking account to separate personal and business expenses and to keep their record keeping simple. Sometimes business owners fear that a separate account will be expensive or cumbersome, but many banks offer free checking to small businesses. Additionally, a separate business account can actually simplify record keeping because you will avoid mixing personal and business expenses. Mixing your business and personal expenses in one account causes confusion at tax time. You might have to pay your tax preparer to untangle the business expenses from your personal expenses. And you run the risk of missing a few deductible business expenses. It is much easier to have separate checking accounts.

I was categorizing a tax client's transactions from his business checking account to prepare his tax return and noticed debit card charges at the grocery store, several restaurants, and the doctor's office. These were clearly personal expenses and not business-related expenses. He had committed a serious offense (in the eyes of his tax preparer!) and he had to pay for my time to sort it all out. Instead, he should have used his personal checking account for family expenses and the business checking account solely for business-related expenses.

## Set up Record Keeping

Record keeping is very important for operating a business successfully. A simple system usually works best. Start with a physical and digital file system for important documents and keep basic financial records in a spreadsheet or accounting software.

You should keep written and digital evidence of your income. This evidence includes:

- bank deposit slips
- sales receipts
- paid invoices from customers
- statements from PayPal or other third-party payers like Square, Stripe, etc.

Expenses are usually more complex than income so you may want to organize the paper evidence into several physical folders and perhaps sort expenses by categories. To make tax preparation easier, use categories that correspond to the sole proprietorship business tax return (Schedule C Profit or Loss from Business). Chapter 4 Tax Forms: Schedule C has a picture of the Schedule C.

Besides keeping documents which prove your income and expenses, you should store your banking documents in a filing system, both physical and digital. Banking records include checking account statements, PayPal (or other third-party payer systems) print outs, and credit card statements.

Keep copies of *everything* you send to the IRS and to your state and city governments. Keep copies of all forms and receipts of paying taxes. Save every letter sent to or received from any government agency, especially confirmation of your EIN (Employer Identification Number), business registration, and fictitious name registration

If you hire employees (and I recommend that you do treat tutors and teachers as employees, [see Chapter 8]), keep payroll records including W-4 and I-9 forms from each employee, quarterly tax filings, receipt of payroll taxes paid, W-2s, and 1099-MISC forms. Your payroll service will provide you with electronic statements each month, quarter, and at year-end. Look these over for accuracy and keep digital files.

For many homeschool business owners, record keeping is an unpleasant chore. When starting a business, keep your bookkeeping system as simple as possible and expand it as your business grows. Record keeping can be easily recorded on paper, or in a spreadsheet program.

I have created a spreadsheet for you to use. You can download it (for free!) at [HomeschoolCPA.com/Spreadsheet](http://HomeschoolCPA.com/Spreadsheet).

If you wish to “graduate” from my spreadsheet to accounting software, there are several programs to choose from, including the popular QuickBooks (available in a desktop and an online version), and several new, online services such as Wave Apps (free) or Freshbooks.com. The market for easy-to-manage business software is growing so in the future you will find many more options.

## Questions and Answers

Q: I’m just helping out at my homeschool program by tutoring one hour a week. I’m not really a business, am I?

A: If you receive compensation (cash, gift cards, or tuition reduction) in exchange for providing services, you are operating a business. If you do it voluntarily and do not get paid (except insubstantially, less than \$25 for a year of volunteering), then you are a volunteer and not a business owner.

By the way, you should not be volunteering for a for-profit business. That is a violation of the Fair Labor Standards Act for a for-profit business to require individuals to volunteer their time and services without compensation.

Q: My Classical Conversations® (CC) Director calls my tutoring for her a “ministry” and encourages me that I am serving homeschool families. Yes, I will get paid, but it only offsets my child’s tuition. I’m not a business owner, am I?

A: Yes, you are a business owner. It may be a tiny or micro business, but when you receive compensation (cash or tuition reduction) in exchange for providing services, you are operating a business. This book will be very helpful to you in tracking your income and expenses and preparing

your tax return properly. Additionally, although you see the money you earn tutoring as offsetting your child's tuition, the IRS doesn't allow you to deduct your tuition as a business expense. (See Chapter 3 for tax-deductible expenses.)

Q: You only mention three business types. What about LLC?

A: LLC or Limited Liability Company status is not a business type for tax purposes. In fact, the IRS considers LLC status as a "disregarded entity," meaning they don't consider your business's LLC status when taxing you. As a sole proprietor, with or without LLC status, you are taxed the same. You could consider adding LLC status to your sole proprietorship business if you want the limited liability protections that LLC status offers, but it doesn't change your tax filings. (See Chapter 2 on LLC Status for details.)

The reason that most businesses use the LLC structure is for *limited liability*. That means the liability is limited to your business and its assets, not your personal assets. I recommend that you learn about LLC status, how to get it, maintain it (there are things you should do like not co-mingle funds and sign contracts in the name of the LLC, etc.), and what is required in your state regarding fees and reports. Some states charge a one-time fee while others charge a yearly fee and require annual reports.

Q: I'm tutoring at a homeschool co-op. Do I need a Doing Business As (DBA) name registration?

A: Maybe not. Without a DBA you should not present yourself with a business name other than your own legal name. So if your business card says Linda Jones, Tutor, you don't need a DBA name. But if you want to use Jones Best Tutoring Services, you need a DBA name registration.

Q: I'm a CC tutor. Do I need an EIN?

A: An EIN (Employer Identification Number) is recommended to keep your Social Security Number (SSN) protected. Without an EIN, you will give your hirer (the CC Director) your SSN. I hope she has good practices for keeping it safe!

Q: As a homeschool teacher at a hybrid program, I only have income and no expenses. Do I really need a separate checking account?

A: You may not need a separate business checking account if you keep good records of all your sources of income.

Q: A business wants to give a donation to our homeschool program (which is owned by me). Can I accept his donation? Is it taxable income to me? Isn't this just a gift from the donor to our program?

A: I assume that the donor is offering you money in exchange for something, probably an opportunity to advertise his products or services. It is unusual for an individual to give a gift to a business. You must record this "donation" as income to your business. In your business bookkeeping, record it as Misc. income or maybe "income from advertising" since I assume that's what is really going on here. It is not a gift.

I fear that you may not have disclosed to the donor that your homeschool program is not a nonprofit organization with 501c3 tax exempt status, and his "donation" is not a gift to a charity. A for-profit business does not receive donations. Only charities receive donations. It's best to let the

donor know that your homeschool program isn't a nonprofit so he doesn't try to claim the donation as a charitable contribution.

Q: My homeschool business holds a fundraiser. All proceeds were spent on an event for the families. There was no profit. It's a wash. Do I need to report the income?

A: Yes. Report the income on your tax return. Fundraisers are taxable income to the business owner. Then record all the expenses related to the fundraiser and the operation of your business. Your profit will not be affected since you spent all that you brought in, but you must show both the income and the expenses on your tax return.

## Chapter 2: Is LLC for Me?

You may have heard about a type of business structure called a Limited Liability Company or LLC. LLC is a legal status granted by your state, and it offers limited liability to protect your personal assets from most business liabilities. LLC status offers certain protections that were once only available to corporations, making it a very popular option for many small businesses. This chapter will explain how LLC status can protect you, what it does not do, and when to consider adding LLC status to your homeschool business.

### Advantages of LLC Status

LLCs offer limited liability protection to sole proprietorships. They are called a single member LLC, because the LLC has only one member—the sole proprietor. Limited liability means that the owner is not personally liable for the debts and liabilities of the business. For example, if a sole proprietorship with LLC status files for bankruptcy, the owner will not be required to pay the business debts from his or her own personal assets such as savings and retirement accounts.<sup>1</sup> The main reason why small business owners choose LLC status for their businesses is to take advantage of limited liability protection.

LLC status does not change your tax status as a sole proprietorship. You do not cease operating as a sole proprietorship when you chose LLC status. I prefer to say that LLC status is added to your sole proprietorship; it does not replace sole proprietorship status. Many online articles confuse readers on this issue. They seem to imply that you must choose between being a sole proprietorship or an LLC, but this is not correct. LLC status does not mean you are no longer a sole proprietor; it is an additional level of protection added to your sole proprietorship.

My accounting business, Carol Topp, CPA, operated as a sole proprietorship for its first six years in business. After six years, I was attracting more clients, some from across the country, and I was generating more income. In addition to obtaining professional liability insurance, I added LLC status to my sole proprietorship. I filed some paperwork in my state and paid a \$125 fee. My business name

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<sup>1</sup> There are situations where an LLC owner can be still held liable for business debts such as personally guaranteeing a loan, intermingling personal and business funds, and committing fraud.

is now Carol Topp, CPA, LLC. I still file the Schedule C as a sole proprietor with my Form 1040 tax return.

## Disadvantages of LLC Status

The disadvantages to forming an LLC are small compared to the advantages:

- There is paperwork to be filed with your state and a fee (varies by state). Most often, the paperwork is easy to understand, especially for a single member LLC. Some individuals file for LLC status without assistance, but some business owners seek professional advice to understand the pros and cons of LLC status for your business. If your LLC has multiple members or is a complex arrangement, you should hire a business attorney to advise you in establishing your LLC.
- Some states impose franchise tax, an annual registration fee or a renewal fee on LLCs. In most states, the fee is about \$100, but California charges a minimum \$800 tax per year on LLCs. To determine your state's requirements, visit your Secretary of State's website.
- LLC status is not a substitute for a general liability insurance policy, so you may still need to purchase insurance to pay any claims.
- There are no tax advantages to LLC status. Your tax structure does not change by adding limited liability status. Earnings from a single-member LLC are still subject to income tax and self-employment taxes, just like a sole proprietorship.

## Protecting your LLC status

To protect your limited liability status, you must keep your business assets (your money) separate from your personal financial assets. Mixing assets may lead a court to determine that your LLC status is weak and, as a result, they will hold you personally liable. New Hampshire attorney John Cunningham cautions, "It isn't enough for business people merely to *have* a liability shield (as an LLC); they must also take reasonable measures to *protect* this shield."

There are several ways to protect your limited liability status:

- Set up a separate checking account for your business.
- Do not mix or intermingle personal expenses and business expenses in the same account.
- Avoid treating business assets (equipment bought by the business) as your own.
- Avoid personal guarantees on business loans.
- Sign all contracts in the name of your LLC, not your personal name.
- Don't commit fraud. Even LLC status can't protect you if you're a crook!
- Purchase business liability insurance.

## When to Consider Limited Liability Status

A small business owner can operate for years without having LLC status, but his or her personal assets are exposed to potential lawsuits and damages. So when should a homeschool business owner consider adding LLC status to her sole proprietorship? LLC status is completely optional so there is no set time, but here are a few things to consider:

- You want to limit the liability your business faces to protect your personal assets.
- You understand the fees and annual reporting your state may impose on LLCs.
- You are willing to separate your business and personal expenses into separate checking accounts.
- You already have liability insurance for your business.
- You can afford to consult with a business attorney or tax professional to fully understand the legal and financial implications of LLC status.

LLC status is the simplest and least expensive way to protect your personal assets. Begin by reading some articles on LLC status, talk to a business professional (a lawyer or CPA), and visit your state's Secretary of State website to learn more. To find out the requirements for forming an LLC in your state, visit <https://www.nolo.com/legal-encyclopedia/form-llc-in-your-state-31019.html>.

## Questions and Answers

Q: If I am an LLC, do I still need to buy insurance? Won't the LLC protect me?

A: LLC status only limits the liability to the company's assets (i.e. your business's assets) if your business is sued or liable. The LLC status will not pay damages if you damage a building or if an individual is injured while at your business. Business liability insurance protects your small business in the event of a lawsuit for personal injury and/or property damages.

Q: If I'm an LLC, do I get any tax breaks?

A: Having LLC status added to your sole proprietorship does not change your tax status. You will still pay taxes as a sole proprietorship (Schedule C as part of your Form 1040).

Q: I'm now a corporation if I'm an LLC, right?

A: No. The "C" in LLC stands for "company" not "corporation." You are still a sole proprietorship, not a corporation.

## Chapter 3: Tax Deductions

### What Is Tax Deductible?

What expenses are tax deductible for a homeschool business owner such as a tutor, teacher, coach, or director for a homeschool program? Lots of things! This chapter lists the most common expenses you will incur. The list of tax-deductible expenses follows the categories on the Schedule C Profit or Loss from Business, the tax form you will be filing each year as part of your Form 1040 tax return.

### Tax Deductible Business Expenses

**Advertising and promotional costs** (including your business website, ads, fliers, and business cards).

**Car expenses.** Trips with a business purpose are tax deductible. This would include mileage to training sessions, to stores to purchase supplies, meetings with employees, etc.

It is debatable if the mileage from your home to your site for homeschool teaching day is tax deductible. The IRS may consider the meeting place for the homeschool program as your main or regular place of business, and therefore the trip from your home to the site is “commuting miles.” Commuting miles are not tax deductible.

In addition to mileage, parking and tolls can be included as tax deductions under car expenses.

Keep a log of your miles including the date, place, reason for the trip, and your miles traveled. The IRS requires the mileage records be kept *contemporaneously*, meaning you should keep records up to date and not rely on your memory to create them later. Estimates are not allowed; there must be actual mileage records. Use your calendar, a log book, Google maps, or anything that is easy for you to record your mileage. I use Google calendar, Google maps, and a spreadsheet to track my business mileage.

Your business miles get multiplied by a set rate determined by the US General Accounting Office every year. The rate for business miles in 2019 was 58 cents per mile. You can do a Google search on “business mileage rate” to determine the updated rates each year. Your tax preparation software will do the calculation automatically when you input the business miles.

**Commission and fees.** This category is used when you pay someone a commission such as finder’s fees, sales commissions, fees for drop shippers, fees for online referrals, and transactions or

processing fees. Bank fees or PayPal fees can be included here. If you collect payments via PayPal, record the full amount paid as income and then record the PayPal fee as an expense. It's tempting to just record the amount you receive after the PayPal fees since that matches what gets deposited into your PayPal account, but the IRS wants you to report your gross income, that means your income before any reduction for the PayPal fee.

**Contract labor** for anyone you pay as an independent contractor rather than as an employee. This might include a bookkeeper, website expert, janitorial help, etc. If you are a CC Director, your tutors should be paid as employees rather than independent contractors because they are providing the key activity of your business. (See Chapter 8: Paying Workers, Tutors, and Teachers.)

If you pay an independent contractor more than \$600 in a calendar year, you must give him or her a Form 1099MISC (and mail a copy to the IRS) to report the money you paid to them. You may want to use an online service such as Yearli.com to fill in and mail the Form 1099MISC. It's not very expensive (about \$5 per form) and easier than filing the 1099-MISC by hand. Beginning in tax year 2020, non-employee compensation will be reported on Form 1099-NEC not the Form 1099-MISC.

**Depletion** does not apply. This applies to the use (depletion) of natural resources such as timber, gas, or oil.

**Depreciation** applies to purchases of buildings, equipment, computers, or furniture that last longer than a year. Depreciation is an accounting term meaning that the value of the building or equipment is deducted over several years. It's a complicated calculation to determine what a business owner can depreciate every year, so I recommend you contact a CPA to prepare your tax return if your business purchases a building or equipment with a cost of more than \$5,000 (what the IRS calls the "de minimis safe harbor"). Give your CPA information on your purchase including the cost and the date of purchase, and he or she will calculate the correct deduction to use on the tax return.

**A Section 179 expense** means that the full cost of the equipment can be deducted in the year it was purchased. Your CPA can determine whether you should depreciate your equipment expenses over time or deduct all of it as a Section 179 expense in the year you bought the equipment.

**Employee Benefit Programs** are rarely offered by small, seasonal homeschool businesses. Most employees of homeschool businesses are part-time, seasonal employees and receive no retirement plan or other benefits.

**Insurance** includes premiums for a general liability policy that you may purchase in the name of your business.

**Mortgage** would rarely be used because most homeschool businesses rent space and do not buy a building for their business activities.

**Legal and professional services** to lawyers and accountants. *You should seriously consider hiring a CPA for tax preparation.* This is not the time to do it yourself. Other hired professionals are listed under Contract Labor (Line 11).

**Office expenses** including postage, paper, ink, envelopes, software and apps that help you run your business.

**Pension and Profit Sharing** will rarely be used because most homeschool business owners do not offer these benefits to their employees.

**Rent** includes renting space for your homeschool program. Some homeschool groups meet in a church and the church may ask for a “donation” in lieu of a fixed amount of rent. This payment is not a donation on your tax return, even if the church calls it that. Your business received something of value (use of space) in exchange for a payment, so it is not a donation. It is rent.

Also be aware that operating a for-profit business in a church could threaten the church’s property tax exemption. Be sure the church knows the for-profit nature of your business. (Read Chapter 9 “Church Use by Businesses” and visit this [FAQ page \[http://homeschoolcpa.com/faq-on-property-tax-for-churches-hosting-homeschool-programs/\]](http://homeschoolcpa.com/faq-on-property-tax-for-churches-hosting-homeschool-programs/) to better understand the implications of a for-profit business operating on church property. Many homeschool businesses have found that either state tax law or the church’s policy forbid for-profit businesses from operating on a church property. The homeschool businesses must find other meeting places besides churches.

**Supplies** includes books, art supplies, classroom supplies, and cleaning supplies related to providing your educational services. Office supplies are listed under Office Expenses (Line 19).

**Taxes and licenses** include music and theater licenses if your students are performing music or a play. It also includes any curriculum licenses such as a Classical Conversations® license, business license, or daycare licenses you may be required to obtain. Although the category says “Taxes,” you cannot deduct the federal income tax or self-employment taxes that you paid this year (or last year). Sorry, but the IRS does not consider taxes you pay to them as a business expense!

**Travel and meals** for business owners including trips to conferences, training sessions, and other out-of-town travel expenses to further your business. You can deduct airline fees, car rental costs, and lodging under Travel.

One-half of the meals spent while on a business trip are tax deductible. You should record the full cost of the meals and enter that number in the tax preparation software on Line 24b. The tax software will calculate the allowed portion (only half of the total expenses) on your tax return. If you take your spouse or family on the trip, only the portion of the meals for you, the business owner, is deductible.

Consider taking the per diem meal expenses instead of actual meal expenses when you travel away from home. It starts at \$55/day and can go up to \$76/day in some high-cost cities (for 2019). Visit [GSA.gov/Travel](http://GSA.gov/Travel) or read IRS Publication 535 Business Expenses (available at [www.IRS.gov](http://www.IRS.gov)) for details.

**Utilities** include cell phone and Internet service charges. The first phone line into a home is considered a personal expense and not deductible as a business expense. Only the business portion of your cell phone or Internet expenses are tax deductible, so separate the cell phone and Internet charges into business use and personal use.

Make a reasonable estimate of your personal and business use of cell phone plan and internet charges. The IRS does not require a log or records of cell phone or Internet use but be reasonable. For example, if four people in your house are using the Internet, it would be reasonable to assume that only one fourth (or less) of the family’s monthly Internet bill could be used for your business and deducted as a business expense on your tax return.

**Wages** include wages and associated employer taxes (FICA, Medicare, workers’ compensation, and unemployment taxes) paid to employees. More information on hiring employees is found in Chapter 8 Paying Workers and in my book [Paying Workers in a Homeschool Organization](#).

**Other Expenses.** Some common business expenses for homeschool business owners include:

books, publications, and online subscriptions that help you run your business.

Professional development to make you a better business owner, director, or tutor, including books, classes, conferences, and workshops.

### **Business Use of the Home**

The business use of the home can be a tax deduction for small business owners who use a home office regularly and exclusively as their principal place of business. Unfortunately, the restrictions of regular and exclusive use make it unlikely you can deduct part of your home as a business expense.

To be eligible to take the home office deduction you must use a specific part of your home *only* for business. This exclusive use requirement means that you cannot mix business and personal activities such as dual use of your dining room table for tutoring and family meals.

Many homeschool business owners conduct their program offsite, not in their homes. Some may have a small home office for managing the business, but the principal business activity is not taking place at home.

If the business use of the home does apply to you, you may find the simplified method helpful. You can calculate the business use of your home office deduction based on the IRS rate of \$5 per square foot. That's a lot simpler than the regular method of adding up utilities, depreciation, mortgage interest, and other home-related expenses.

## What Is Not Tax Deductible?

**Personal expenses.** Personal expenses such as your child's books, curriculum, and tuition payments or licensing fees are not tax deductible. Your personal use of your cell phone or Internet is not tax deductible. Your wardrobe is not tax deductible.

**Charitable contributions are tax deductible if you itemize, but they are not business deductions.** If your family makes a donation to a qualified charity, that donation goes on Schedule A Itemized deductions. If your business makes a donation, it still goes on the Schedule A Itemized deductions. It is not a business expense.

**Your "salary"** is not a business deduction. Business owners operating as a sole proprietor are not paid a salary nor wages. Their pay is that they get to keep all the profit from the business as their income. Only wages and salaries that you pay to your employees are business tax deductions. (Read Chapter 7 Paying Yourself for details.)

**Your landline phone**, even if used for business is not tax deductible.

**Your children's tuition** and fee payments are personal expenses and are not business deductions.

**Childcare expenses.** If you pay a babysitter or nanny so that you can work, you can deduct these expenses on the Childcare Tax Credit Form 2441, but these childcare expenses are not business expenses. Do not put the childcare expense on your Schedule C tax form.

## Questions and Answers

Q: As a CC Director, I have to enroll my own children. Can I take a tax deduction for their tuition since it's a required expense of running my business?

A: No, you cannot deduct your child's tuition as a business expense, even if it is required under your license agreement that you must enroll your child. This expense is a personal expense and not tax deductible.

Q: I'm a CC Director and part of my work is done on Community Day, but I spend a lot of time working from home too. Can I deduct Business Use of the Home?

A: Maybe. Your principal place of business is at another location on Community Day, not your home. The IRS states:

You must show that you use your home as your principal place of business. If you conduct business at a location outside of your home, but also use your home substantially and regularly to conduct business, you may qualify for a home office deduction.

For example, if you have in-person meetings with patients, clients, or customers in your home in the normal course of your business, even though you also carry on business at another location, you can deduct your expenses for the part of your home used exclusively and regularly for business.<sup>2</sup>

So your home must be used substantially to conduct business and you must still meet the exclusive use test. If you have a part of your home set aside only for substantial business use, you may be able to deduct the Business Use of the Home. IRS Publication 587 has more details.

Q: I'm a tutor for a homeschool program, paid as an independent contractor. Can I deduct the mileage from my home to the location where I tutor?

A: No, you cannot deduct these miles. The homeschool program location is your primary place of business. Your mileage from your home to the homeschool program location is commuting, and commuting expenses are not tax deductible.

Q: I'm a CC Director and must pay a license fee to CC for all the children enrolled, including mine. Do I need to pay my business tuition for my own children as well? It seems odd to be paying myself.

A: You should not write your business a check for your own children's tuition. Additionally, you do not include your child's tuition in the business income reported on your tax return. The reason is a principle in taxation called imputed income. It states that a person should not be taxed when they avoid paying for services by providing the services to themselves. For example, since I'm a CPA, I prepare my own tax return at a value of \$500. I do not charge myself for providing the services to myself. I do not write a check for \$500 to my business nor do I include \$500 in my business income on my tax return.

Since you pay your licensing fee to CC based on student enrollment, you should track the total enrollment *including your own children* in that head count. That way you are paying the correct amount for your licensing fee, but you do not need to write a tuition check to your business for your child's tuition.

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<sup>2</sup> "Home Office Deduction" <https://www.irs.gov/businesses/small-businesses-self-employed/home-office-deduction> accessed November 6, 2019

## Chapter 4: Tax Forms: Schedule C

In Chapter 1 “Business Start-Up,” I said that most homeschool businesses are sole proprietorships. This chapter will explain the tax forms for a sole proprietorship. As a sole proprietor, your business taxes are filed with your personal income tax return. Partnerships and corporations file tax returns that are separate from their individual owners. Their tax situations are beyond the scope of this book. I focus on sole proprietorships because that structure applies to most homeschool businesses.

### Why Do I Have to File a Tax Return If I Didn’t Make Any Money?

If you do not make much or any profit, you may wonder if you must file a tax return. I’ve heard business owners say, “But I didn’t make any money this year!” I explain that they must file a tax return to show they didn’t make a profit! You must file a tax return because you have *income*—the cash payments you received from your customers. In the United States we have an *income* tax, so we Americans must report all of our income. Business owners can reduce their taxes by also reporting legitimate business expenses. You must file a tax return even if you didn’t make a profit because you must report all your income and, additionally, you can report business expenses that reduced your profit which will reduce the tax you will pay. You report your business income and expenses on Schedule C Profit or Loss from Business as part of your personal income tax return, IRS Form 1040.

### Which Schedule C Tax Form Do You Need?

Most people do not like dealing with numbers and taxes, but it is a good idea to become familiar with some important tax forms, especially the Schedule C Profit or Loss from Business.

There are two versions of the Schedule C. The Schedule C-EZ is a simple, one-page form; the 2-page Schedule C is more detailed.

The Schedule C-EZ does not require you to list all your expenses in detail; you just report your total expenses as one number. You can use the Schedule C-EZ form if:

- Your expenses are \$5,000 or less during the calendar year.
- You have no inventory that you buy, hold, and resell.

- You do not have a loss.
- You have no employees.
- You have some other uncommon tax issues listed on the Form C-EZ.

We're going to go over the Schedule C line by line.

<b>SCHEDULE C</b> <b>(Form 1040 or 1040-SR)</b> Department of the Treasury Internal Revenue Service (99)		<b>Profit or Loss From Business</b> (Sole Proprietorship) ▶ Go to <a href="http://www.irs.gov/ScheduleC">www.irs.gov/ScheduleC</a> for instructions and the latest information. ▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships generally must file Form 1065.		OMB No. 1545-0074 <b>2019</b> Attachment Sequence No. 09	
Name of proprietor			Social security number (SSN)		
<b>A</b> Principal business or profession, including product or service (see instructions)			<b>B</b> Enter code from instructions ▶		
<b>C</b> Business name. If no separate business name, leave blank.			<b>D</b> Employer ID number (EIN) (see instr.) 		
<b>E</b> Business address (including suite or room no.) ▶ City, town or post office, state, and ZIP code					
<b>F</b> Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶					
<b>G</b> Did you "materially participate" in the operation of this business during 2019? If "No," see instructions for limit on losses					<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>H</b> If you started or acquired this business during 2019, check here					<input type="checkbox"/>
<b>I</b> Did you make any payments in 2019 that would require you to file Form(s) 1099? (see instructions)					<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>J</b> If "Yes," did you or will you file required Forms 1099?					<input type="checkbox"/> Yes <input type="checkbox"/> No

### Name and Number

The first few lines of the Schedule C and C-EZ are pretty straight forward with name, address, and so on. A sole proprietor may use her Social Security Number or she can apply to receive an Employer Identification Number (EIN) from the IRS and record the EIN in Box D instead of their Social Security Number. To receive an EIN (at no charge), visit [www.IRS.gov](http://www.IRS.gov) and search for EIN. You can apply online or by mail.

Many businesses may have a separate business name. If you have a business name, enter it in Line C. You should register this business name with your county or state government. It may be called a DBA (Doing Business As) registration or a fictitious business name registration. Visit <http://dbafilingonline.com/dba-by-state/> for details.

### Method of Accounting: Cash or Accrual

Line F Method of Accounting can be confusing. (The Schedule C-EZ does not ask this question). The cash basis of accounting is most common. It means that you report your income when the cash is received, regardless of when you did the work. For example, if you collect tuition or fees in December but do not earn this money until January, you record the income in December, when you received the cash.

The accrual system records income when it is earned, even if it was paid earlier. Using the same example, you receive the tuition in December but record it as earned in each month as the new semester goes forward.

We use the cash basis on our personal income tax. Nearly all homeschool businesses use the cash method of accounting. Some businesses may use the accrual basis if instructed to do so by their CPA and if they really understand how to record transactions in an accrual system, since it is more complex. I highly recommend using accounting software if you wish to use the accrual accounting system.

**Material Participation**

Line G asks if you materially participated in the business. Answer Yes. To materially participate means you were actively working in the business, not just a silent partner or investor.

**Start Business**

Line H asks if you started the business in the current tax year, meaning this is the first year of running the business. That seems pretty self-explanatory. If you started the business in the current tax year, check the box. If you have been running the business for a while, don't check the box. If you've been running the business, but never reported the income or expenses on your tax return, contact a CPA and correct your prior year's tax returns.

**Payments on 1099**

Both the Schedule C and C-EZ ask a question on Line I: Did you make any payments that would require you to file Form(s) 1099? The Form 1099-MISC is the form you give to an independent contractor that you paid more than \$600 in the past calendar year. You should also give attorneys a 1099-MISC regardless of the amount you paid them.

If you failed to give your independent contractors or attorney a 1099-MISC (or 1099-NEC starting in tax year 2020), contact a CPA to file the Form 1099-MISCs immediately. There may be penalties for failure to give your independent contractors a 1099-MISC. The forms are due to the independent contractor and to the IRS by January 31 each year.

**Gross Receipts or Income**

<b>Part I Income</b>		
<b>1</b>	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked . . . . . <input type="checkbox"/>	<b>1</b>
<b>2</b>	Returns and allowances . . . . .	<b>2</b>
<b>3</b>	Subtract line 2 from line 1 . . . . .	<b>3</b>
<b>4</b>	Cost of goods sold (from line 42) . . . . .	<b>4</b>
<b>5</b>	<b>Gross profit.</b> Subtract line 4 from line 3 . . . . .	<b>5</b>
<b>6</b>	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) . . . . .	<b>6</b>
<b>7</b>	<b>Gross income.</b> Add lines 5 and 6 . . . . . <input type="checkbox"/>	<b>7</b>

Part I of the Schedule C is where a business owner reports his or her business income. On the Schedule C-EZ it is called Gross Receipts and is Line 1. Part I Line 1 Gross Receipts or Sales is where you add up what you received from all your sources of income including registration fees, tuition, supply fees, facility fees, special event income, etc. If you are paid as a tutor and receive a 1099-

MISC, it goes on Line 1. Even if you did not receive a 1099-MISC, your total income goes on Line 1.

On the Schedule C there are several lines that follow Line 1 Gross Receipts of Sales. There are lines for Returns and for Cost of Goods Sold. These lines (2 and 4) are for businesses that buy, hold, and resell inventory. If you do not have Returns or Cost of Goods Sold, then Line 1 Gross Receipts, Line 5 Gross Profit, and Line 7 Gross Income on Schedule C will all be the same number.

Total it all up and record the total Gross Income on Line 7.

Expenses

<b>Part II Expenses.</b> Enter expenses for business use of your home <b>only</b> on line 30.			
<b>8</b>	Advertising . . . . .	<b>8</b>	
<b>9</b>	Car and truck expenses (see instructions) . . . . .	<b>9</b>	
<b>10</b>	Commissions and fees . . . . .	<b>10</b>	
<b>11</b>	Contract labor (see instructions) . . . . .	<b>11</b>	
<b>12</b>	Depletion . . . . .	<b>12</b>	
<b>13</b>	Depreciation and section 179 expense deduction (not included in Part III) (see instructions) . . . . .	<b>13</b>	
<b>14</b>	Employee benefit programs (other than on line 19) . . . . .	<b>14</b>	
<b>15</b>	Insurance (other than health) . . . . .	<b>15</b>	
<b>16</b>	Interest:		
<b>a</b>	Mortgage (paid to banks, etc.) . . . . .	<b>16a</b>	
<b>b</b>	Other . . . . .	<b>16b</b>	
<b>17</b>	Legal and professional services . . . . .	<b>17</b>	
<b>18</b>	Office expense (see instructions) . . . . .	<b>18</b>	
<b>19</b>	Pension and profit-sharing plans . . . . .	<b>19</b>	
<b>20</b>	Rent or lease (see instructions):		
<b>a</b>	Vehicles, machinery, and equipment . . . . .	<b>20a</b>	
<b>b</b>	Other business property . . . . .	<b>20b</b>	
<b>21</b>	Repairs and maintenance . . . . .	<b>21</b>	
<b>22</b>	Supplies (not included in Part III) . . . . .	<b>22</b>	
<b>23</b>	Taxes and licenses . . . . .	<b>23</b>	
<b>24</b>	Travel, meals, and entertainment:		
<b>a</b>	Travel . . . . .	<b>24a</b>	
<b>b</b>	Deductible meals and entertainment (see instructions) . . . . .	<b>24b</b>	
<b>25</b>	Utilities . . . . .	<b>25</b>	
<b>26</b>	Wages (less employment credits) . . . . .	<b>26</b>	
<b>27a</b>	Other expenses (from line 48) . . . . .	<b>27a</b>	
<b>b</b>	<b>Reserved for future use . . . . .</b>	<b>27b</b>	
<b>28</b>	<b>Total expenses</b> before expenses for business use of home. Add lines 8 through 27a . . . . . ▶	<b>28</b>	

Chapter 3: “What’s Tax Deductible for a Homeschool Business Owner?” goes into great detail for each of these categories of expense, so refer to that chapter for help in recording your expenses on the correct lines in Part II.

On the Schedule C-EZ, you do not record the expenses by categories. Instead, you sum all your expenses and put the sum on Line 2.

## Net Profit

<p><b>31 Net profit or (loss).</b> Subtract line 30 from line 29.</p> <ul style="list-style-type: none"> <li>• If a profit, enter on both <b>Schedule 1 (Form 1040 or 1040-SR), line 3</b> (or <b>Form 1040-NR, line 13</b>) and on <b>Schedule SE, line 2</b>. (If you checked the box on line 1, see instructions). Estates and trusts, enter on <b>Form 1041, line 3</b>.</li> <li>• If a loss, you <b>must</b> go to line 32.</li> </ul>	}	<table border="1" style="width: 100%; height: 40px;"> <tr> <td style="width: 15%; text-align: center; vertical-align: middle;"><b>31</b></td> <td style="width: 85%;"></td> </tr> </table>	<b>31</b>	
<b>31</b>				

Follow the instructions to calculate Net Profit on Line 3 of the Schedule C-EZ or Line 31 in Schedule C. It's simple math and, of course, tax preparation software will do it for you.

Look at the amount of net income. It's your profit. It is your earnings. It's how you got paid for your work in running your business. Does it seem correct to you? Does it match your record keeping? If you use my spreadsheet mentioned in Chapter 1 "Business Start-Up," it should come very close. Net Profit on the Schedule C might be a bit different from your records because:

- **Meals:** Business owners can only deduct 50% of business-related meals.
- **Mileage:** You can deduct business miles driven at a rate determined by the IRS.
- **Utilities:** You can deduct the business portion of cell phone and internet, even if you paid the bill from your personal checking account.
- **Business Use of the Home:** If you are eligible, you can deduct part of your home used exclusively for business. (See Chapter 3 for details.)

These are legitimate business deductions but may not be cash outlays. Typically, you will have larger expenses on your tax return than you record in your bookkeeping because of these expenses.

## Cost of Goods Sold

Cost of Goods Sold is calculated in Part III on page 2 of the Schedule C. It is the cost of purchasing and shipping any inventory that you buy, hold, and resell. Some homeschool tutorial programs may purchase books or curriculum for a group of students for the convenience of the parents. If there is no markup of the purchase price, then simply include the income from selling the curriculum on Line 1 of Schedule C and the cost of these materials in either Line 2 Supplies or Line 27 Other and label it "Classroom supplies."

If you do buy and sell inventory, please consult with a tax professional, an Enrolled Agent, or Certified Public Accountant. Inventory management requires detailed bookkeeping on purchases, sales, returns, etc. It may involve collecting and remitting sales tax, too. Accounting for inventory is complex and beyond the scope of this book.

## Information on Your Vehicle

The last part of the Schedule C and C-EZ, Part IV and Part III respectively, ask for information about your vehicle. Fill in this section if you used your automobile for business. Please read Chapter 3 to determine if you can deduct mileage on your tax return. You must keep a mileage log with dates, location, and miles driven. These questions will be easy to answer if you kept a log. If you used more than one automobile, just sum the amounts together for both cars.

For example, Stephanie drives the family van 500 business-related miles during the year. Her husband drives a truck and commutes to work. Sarah had to use the truck a few times for business use, adding another 50 business miles. So, they report:

Business miles: 550 (500 on the van and 50 on the truck)

Commuting miles: 7,000 for her husband

Other (personal) miles: 25,000

The 550 business-related miles gets multiplied by the IRS mileage rate and entered on Line 9 Car and Truck Expenses.

## Schedule SE

Following Line 31 Net Profit (Line 3 on the Schedule C-EZ) are some instructions to copy your profit to the Form 1040 and to another IRS form—Schedule SE. Tax software does this for you, but if you're doing your taxes by hand (please don't!), don't neglect to follow the instructions.

Schedule SE is discussed in detail in the following chapter. It is used to calculate your Self Employment Tax. Self-Employment tax is the same as Social Security and Medicare for self-employed individuals. Sole proprietors are self-employed and must pay self-employment tax in addition to federal income tax.

## Qualified Business Income Deduction

In 2018 Congress passed a new tax deduction as part of the Tax Cuts and Jobs Act. It's called the Qualified Business Income (QBI) Deduction. The QBI tax deduction is equal to 20% of your profit (minus some deductions) from a "qualified business." Tutoring and teaching are both "qualified businesses" if operated as anything except a C corporation.

If your taxable income is less than \$157,500 for a single person or \$315,000 for married filing joint (in 2019), you can claim the 20% QBI tax deduction. If your income is more than those thresholds, your deduction will be phased out.

There are some additional restrictions and complications, especially if your business is an S Corporation, pays wages to employees, or if you have several businesses. So consult a tax professional (an Enrolled Agent or CPA) if those situations apply to you.

The Qualified Business Income Deduction is calculated on IRS Form 8995 and displayed on Line 10 of the Form 1040. Your tax prep software may not calculate the deduction automatically; you may have to answer some questions on the Form 8995 to trigger the deduction. Sample tax returns in Chapter 6 show the QBI deduction.

## Questions and Answers

Q: I'm a new CC Director. I collected a full year of tuition from my families (i.e., customers) in the fall. When I prepared my tax return, it showed I have a large profit, but I know this money is going to be all spent on tutor payroll by the end of May. Do I have to pay tax on all that profit now? What can I do?

A: A CC Director may collect all the tuition and fees in the fall, leaving a large surplus at the end of the year. The IRS says this surplus is all profit and therefore taxable income. At the end of the *school year* the Director will show a much smaller profit, but the taxes get reported at the end of December when it looks like she has a large profit.

Here's what she can do:

- Only collect fall tuition in the fall. Collect spring tuition in January. In other words, time your income to more closely match the delivery of your services.
- Realize that this only happens in the first year. The next calendar year the profit will be lower because the expenses for both semesters (spring and fall) will be recorded on the tax return. As a matter of fact, if a CC Director closes the business, she actually may have a loss in the final year if her expenses from both semesters exceed her income from only one semester.
- Consult with a CPA about using accrual accounting which recognizes income when it is *earned*, not when it is received. Accrual accounting might be overly complex for a small business like most CC Communities, but with the help of an experienced small business accountant it could be a practical solution for you. Switching from cash to accrual accounting requires notifying the IRS via IRS Form 3115. Your tax professional can help file the form correctly.

Q: I tutor at a homeschool program, and I was paid \$500 in the year. I did not receive a 1099-MISC. I don't have to report that income, do I? I was told I only need to report it if I earned more than \$600.

A: You must report all the income you received even if you did not receive a 1099-MISC (or 1099-NEC starting tax year 2020). The \$600 threshold is when the homeschool business who hired you needs to give you a 1099-MISC, but you are still obligated to report your income on a Schedule C or C-EZ.

Q: I like the sound of that QBI deduction. It's not showing up on Line 9 of my Form 1040. We prepare our own tax return. Am I not eligible for the QBI deduction?

A: Tax software is great if you use it like it expects to be used. Make sure you have filled in all the information on the Form 8995 in your tax software. Take your time. Sometimes it's a little thing like clicking a box. Hunt for any highlighted unanswered boxes. If it's still not working, email the tax software provider.

## Chapter 5: Tax Forms: Schedule SE

Most homeschool business owners are aware that if they have a successful business, they will owe federal, state, and local income taxes. But in my experience new business owners do not know about self-employment tax. It surprises them with another tax on their profit.

### The Hidden Tax: Self-Employment

<b>SCHEDULE 4</b> (Form 1040)		<b>Other Taxes</b>		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service		▶ Attach to Form 1040. ▶ Go to <a href="http://www.irs.gov/Form1040">www.irs.gov/Form1040</a> for instructions and the latest information.		<b>2018</b> Attachment Sequence No. <b>04</b>	
Name(s) shown on Form 1040				Your social security number	
<b>Other Taxes</b>	<b>57</b>	Self-employment tax. Attach Schedule SE . . . . .	<b>57</b>		
	<b>58</b>	Unreported social security and Medicare tax from: Form a <input type="checkbox"/> 4137 b <input type="checkbox"/> 8919	<b>58</b>		
	<b>59</b>	Additional tax on IRAs, other qualified retirement plans, and other tax-favored accounts. Attach Form 5329 if required.	<b>59</b>		

The self-employment tax is found on the Form 1040 Schedule 2 Additional Taxes on Line 4 and carried to the Form 1040 on Line 15. It is not in bold print like the federal income tax, so I call it the “hidden” tax. Many new business owners are unaware that they owe self-employment tax until they prepare their tax returns and are surprised by a rather large number on Line 14 of their Form 1040 (for years 2018 and beyond).

If a sole proprietor has a net income (profit) of over \$400 a year from her business, she will owe self-employment tax *in addition* to federal income tax. Self-employment tax is the same as Social Security and Medicare for self-employed people (sole proprietors are self-employed). The self-employment tax rate is approximately 15% of your net income (i.e., profit). The self-employment tax is calculated on Schedule SE.

The Schedule SE comes in two versions: the short version (Part A) and the long one (Part B). The Schedule SE begins with a question-and-answer tree to help you determine if you are eligible

for the shorter calculation. More than likely, most homeschool business owners, tutors in homeschool programs, and CC Directors can use the short Schedule SE.

<b>SCHEDULE SE</b> (Form 1040 or 1040-SR)	<b>Self-Employment Tax</b>	OMB No. 1545-0074  <b>2019</b> Attachment Sequence No. <b>17</b>
Department of the Treasury Internal Revenue Service (99)	▶ Go to <a href="http://www.irs.gov/ScheduleSE">www.irs.gov/ScheduleSE</a> for instructions and the latest information. ▶ Attach to Form 1040, 1040-SR, or 1040-NR.	
Name of person with self-employment income (as shown on Form 1040, 1040-SR, or 1040-NR)	Social security number of person with self-employment income ▶	

**Before you begin:** To determine if you must file Schedule SE, see the instructions.

---

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

**Note:** Use this flowchart *only* if you must file Schedule SE. If unsure, see *Who Must File Schedule SE* in the instructions.

```

graph TD
    Q1{Did you receive wages or tips in 2019?}
    Q2{Are you a minister, member of a religious order, or Christian Science practitioner who received IRS approval not to be taxed on earnings from these sources, but you owe self-employment tax on other earnings?}
    Q3{Are you using one of the optional methods to figure your net earnings (see instructions)?}
    Q4{Did you receive church employee income (see instructions) reported on Form W-2 of $108.28 or more?}
    Q5{Was the total of your wages and tips subject to social security or railroad retirement (tier 1) tax plus your net earnings from self-employment more than $132,900?}
    Q6{Did you receive tips subject to social security or Medicare tax that you didn't report to your employer?}
    Q7{Did you report any wages on Form 8919, Uncollected Social Security and Medicare Tax on Wages?}
    A1[You may use Short Schedule SE below]
    A2[You must use Long Schedule SE on page 2]

    Q1 -- No --> Q2
    Q1 -- Yes --> Q5
    Q2 -- No --> Q3
    Q2 -- Yes --> A2
    Q3 -- No --> Q4
    Q3 -- Yes --> A2
    Q4 -- No --> A1
    Q4 -- Yes --> A2
    Q5 -- No --> Q6
    Q5 -- Yes --> A2
    Q6 -- No --> Q7
    Q6 -- Yes --> A2
    Q7 -- No --> A1
    Q7 -- Yes --> A2
    
```

The opening question might be confusing: Did you receive wages or tips? The IRS is not asking about your spouse’s wages for a job, nor are they asking if you have a job with wages. They are asking if your *business*—which you described on Schedule C—provides you with wages or tips. This is *highly unlikely* for business owners who form their business as a sole proprietorship. Sole proprietors do not give themselves wages (or tips). (See Chapter 7 “Paying Yourself.”) There are a few specific occupations which are a combination of employee and business owner called statutory employees. The occupations usually involve ministers or insurance salespeople. Most likely, you will answer No, you did not receive wages.

Section A—Short Schedule SE. <b>Caution:</b> Read above to see if you can use Short Schedule SE.		
<b>1a</b> Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A . . . . .	<b>1a</b>	
<b>b</b> If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code AH . . . . .	<b>1b</b> ( )	
<b>2</b> Net profit or (loss) from Schedule C, line 31; and Schedule K-1 (Form 1065), box 14, code A (other than farming). Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report . . . . .	<b>2</b>	
<b>3</b> Combine lines 1a, 1b, and 2 . . . . .	<b>3</b>	
<b>4</b> Multiply line 3 by 92.35% (0.9235). If less than \$400, you don't owe self-employment tax; don't file this schedule unless you have an amount on line 1b . . . . .	<b>4</b>	
<b>Note:</b> If line 4 is less than \$400 due to Conservation Reserve Program payments on line 1b, see instructions.		
<b>5 Self-employment tax.</b> If the amount on line 4 is: <ul style="list-style-type: none"> <li>• \$132,900 or less, multiply line 4 by 15.3% (0.153). Enter the result here and on <b>Schedule 2 (Form 1040 or 1040-SR), line 4, or Form 1040-NR, line 55.</b></li> <li>• More than \$132,900, multiply line 4 by 2.9% (0.029). Then, add \$16,479.60 to the result. Enter the total here and on <b>Schedule 2 (Form 1040 or 1040-SR), line 4, or Form 1040-NR, line 55 .</b></li> </ul>	<b>5</b>	
<b>6 Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (0.50). Enter the result here and on <b>Schedule 1 (Form 1040 or 1040-SR), line 14, or Form 1040-NR, line 27 . . . . .</b>	<b>6</b>	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 11358Z **Schedule SE (Form 1040 or 1040-SR) 2019**

The rest of the Form SE is simple calculations. Your tax software will fill in the correct amounts. If you prefer to fill in the form by hand (or want to check the software’s math), follow the instructions down to Lines 5 and 6 which instruct you to copy the SE tax to specific lines on the Form 1040. Line 6 is a calculation of a tax deduction for self-employed taxpayers. One half of the Self-employment tax is deducted from your income, so self-employed individuals get a tax deduction on the Form 1040 Schedule 1 Line 27.

Overall, the Schedule SE is an easy form to complete, but it is very important, so do not neglect it or you will get a letter and a tax bill from the IRS!

### Questions and Answers

**Q:** I just saw my tax return, and that self-employment (SE) tax is a lot! Are there some deductions I can take to lower it?

**A:** Sorry, no. The SE tax is a straight percentage (approximately 15%) of your profit. You already took all the deductions (as business expenses) you are entitled to when you calculated your profit on your Schedule C (called Net Income on Line 31).

In the future, I recommend you set aside 25-30% of your profit to cover the federal income tax (about 10% for most Americans) and 15% for SE tax. It’s not unusual for a small business owner to owe more in SE tax than in federal income tax (after deductions and credits).

## Chapter 6: Sample Tax Returns

This chapter gives two sample tax returns of a homeschool business owner and a tutor in a homeschool program paid as an independent contractor<sup>3</sup>. By showing you these two samples, I am not holding them up as examples of what your income, expenses, or profit from your business should be. *Your tax return will look different.* Your expenses and income will be different. These sample returns are only to be used as a teaching tool so that you can better understand your own tax return and avoid making costly and embarrassing mistakes.

In both examples, I assume a married couple filing jointly with two children. The business owner's spouse has wages of \$70,000 and no other sources of income. The couple does not itemize deductions for simplicity's sake in the examples.

### Sample Tax Return for a Program Owner

The first example is for Ashley, the owner of a homeschool program offering classes to 50 students one day a week. She files a Schedule C to report her income and expenses. Ashley's total income from her business is \$35,000. Her expenses which include a licensing fee, insurance, tutor wages and payroll taxes, a payroll service, rent, and supplies total \$28,275. Her profit is \$6,725 (Line 31 on the Schedule C).

Here is Ashley's Schedule C Profit or Loss from Business. She categorizes expenses into the various lines on the Schedule C.

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<sup>3</sup> By showing a tutor working as an independent contractor, I am not endorsing that payment arrangement. Frequently, tutors or teachers in a homeschool program should be paid as employees, not as independent contractors. See my book *Paying Workers in a Homeschool Organization* for more information on correctly classifying and paying your workers.

<b>SCHEDULE C</b> <b>(Form 1040)</b>  <small>Department of the Treasury Internal Revenue Service (99)</small>	<b>Profit or Loss From Business</b> (Sole Proprietorship)  ▶ Go to <a href="http://www.irs.gov/ScheduleC">www.irs.gov/ScheduleC</a> for instructions and the latest information. ▶ Attach to Form 1040, 1040NR, or 1041; partnerships generally must file Form 1065.	<small>OMB No. 1545-0074</small>  <b>2018</b> Attachment Sequence No. <b>09</b>
Name of proprietor <b>Ashley Business</b>		Social security number (SSN) <b>555-55-5555</b>
<b>A</b> Principal business or profession, including product or service (see instructions) <b>Tutoring, Education</b>		<b>B</b> Enter code from Instructions ▶ <b>611000</b>
<b>C</b> Business name. If no separate business name, leave blank. <b>CC of Anytown</b>		<b>D</b> Employer ID number (EIN) (see instr.)
<b>E</b> Business address (including suite or room no.) ▶ _____ City, town or post office, state, and ZIP code		
<b>F</b> Accounting method: (1) <input checked="" type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶ _____		
<b>G</b> Did you "materially participate" in the operation of this business during 2018? If "No," see instructions for limit on losses . . . . .		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<b>H</b> If you started or acquired this business during 2018, check here . . . . .		<input type="checkbox"/> Yes <input type="checkbox"/> No
<b>I</b> Did you make any payments in 2018 that would require you to file Form(s) 1099? (see instructions) . . . . .		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<b>J</b> If "Yes," did you or will you file required Forms 1099? . . . . .		<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<b>Part I Income</b>		
1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked . . . . . <input type="checkbox"/>	35,000.
2	Returns and allowances . . . . .	
3	Subtract line 2 from line 1 . . . . .	35,000.
4	Cost of goods sold (from line 42) . . . . .	
5	Gross profit. Subtract line 4 from line 3 . . . . .	35,000.
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) . . . . .	
7	Gross income. Add lines 5 and 6 . . . . .	35,000.
<b>Part II Expenses. Enter expenses for business use of your home only on line 30.</b>		
8	Advertising . . . . .	
9	Car and truck expenses (see instructions) . . . . .	
10	Commissions and fees . . . . .	
11	Contract labor (see instructions) . . . . .	
12	Depletion . . . . .	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions) . . . . .	
14	Employee benefit programs (other than on line 19) . . . . .	
15	Insurance (other than health) . . . . .	500.
16	Interest (see instructions):	
16a	a Mortgage (paid to banks, etc.) . . . . .	
16b	b Other . . . . .	
17	Legal and professional services . . . . .	500.
18	Office expense (see instructions) . . . . .	475.
19	Pension and profit-sharing plans . . . . .	
20	Rent or lease (see instructions):	
20a	a Vehicles, machinery, and equipment . . . . .	
20b	b Other business property . . . . .	3,500.
21	Repairs and maintenance . . . . .	
22	Supplies (not included in Part III) . . . . .	1,800.
23	Taxes and licenses . . . . .	
24	Travel and meals:	
24a	a Travel . . . . .	
24b	b Deductible meals (see instructions) . . . . .	
25	Utilities . . . . .	
26	Wages (less employment credits) . . . . .	21,500.
27a	Other expenses (from line 48) . . . . .	
27b	b Reserved for future use . . . . .	
28	Total expenses before expenses for business use of home. Add lines 8 through 27a . . . . .	28,275.
29	Tentative profit or (loss). Subtract line 28 from line 7 . . . . .	6,725.
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method (see instructions). Simplified method filers only: enter the total square footage of: (a) your home: _____ and (b) the part of your home used for business: _____. Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30 . . . . .	
31	Net profit or (loss). Subtract line 30 from line 29. • If a profit, enter on both <b>Schedule 1 (Form 1040), line 12</b> (or <b>Form 1040NR, line 13</b> ) and on <b>Schedule SE, line 2</b> . (If you checked the box on line 1, see instructions). Estates and trusts, enter on <b>Form 1041, line 3</b> . • If a loss, you must go to line 32.	6,725.

Ashley's profit of \$6,725 is carried to Schedule 1 Additional Income Line 3 (shown on the following page) and Schedule SE. Ashley is eligible to file the short Schedule SE Part A (not shown). She owes \$950 in self-employment tax to pay for Social Security and Medicare. Self-employment tax is calculated on Schedule SE and is approximately 15% of her profit.



Of course, they have credits and taxes withheld, so in the end they actually get a refund! The numbers for your tax return will be different, but you should expect to use the same Forms and Schedules, specifically:

- Form 1040
- Schedule 1 to list profit from your business and a deduction for one-half of self-employment tax.
- Schedule 2 to display the amount of self-employment tax owed.
- Schedule C to display your income and expenses from a business
- Schedule SE to calculate Self Employment tax
- Form 8995 to calculate the amount of the Qualified Business Income deduction

### Sample Tax Return for a Tutor

Here is sample tax return for Tessa, an independent contractor tutor at a homeschool program. Our basic assumptions are: married filing joint, two children, \$55,000 in wages from her spouse.

Tessa earns \$750 from teaching. Her expenses total \$77. They include a few office and classroom supplies. Since her expenses were less than \$5,000 and she has no employees, Tessa can file the Schedule C-EZ.

On the Schedule C-EZ she does not list details about her expenses. She only lists the total expenses of \$77. Her profit from her teaching business is \$673.

<b>SCHEDULE C-EZ</b> (Form 1040)  Department of the Treasury Internal Revenue Service (99)	<b>Net Profit From Business</b> (Sole Proprietorship) ▶ Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B ▶ Attach to Form 1040, 1040NR, or 1041	OMB No. 1545-0074  <b>2018</b> Attachment Sequence No. <b>09A</b>
Name of proprietor Tutor Contractor		Social security number (SSN) 001-11-2233
<b>Part I General Information</b>		
You May Use Schedule C-EZ Instead of Schedule C Only If You: <ul style="list-style-type: none"> <li>● Had business expenses of \$5,000 or less</li> <li>● Use the cash method of accounting</li> <li>● Did not have an inventory at any time during the year</li> <li>● Did not have a net loss from your business</li> <li>● Had only one business as either a sole proprietor, qualified joint venture, or statutory employee</li> <li>● Had no employees during the year</li> <li>● Are not required to file Form 4562, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, to find out if you must file</li> <li>● Do not deduct expenses for business use of your home</li> <li>● Do not have prior year unallowed passive activity losses from this business</li> </ul>		
Loss - Principal business or profession Tutor	<b>B Select type of business</b> ▶ View All Codes  Select code for business type ▶ 611000	
Principal product or service Tutoring	<b>C Business name.</b> If no separate business name, leave blank.	
<b>E Business address</b> (including suite or room no.)		<b>D Employer ID number (EIN), if any</b>
City	State	ZIP code
Employee's foreign country	Foreign province/county	Foreign postal code
F Did you make any payments in 2018 that would require you to file Form(s) 1099? ..... <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A		
G If "Yes", did you or will you file all required Forms 1099? ..... <input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> N/A		
<b>Part II Figure Your Net Profit</b>		
<b>1 Gross receipts. Caution.</b> If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see <i>Statutory employees</i> in the instructions for Schedule C, line 1, and check here ..... ▶ <input type="checkbox"/>	<b>1</b>	750
<b>2 Total expenses</b> (see page 2). If more than \$5,000, you <b>must</b> use Schedule C .....	<b>2</b>	77
<b>3 Net profit.</b> Subtract line 2 from line 1. If less than zero, you <b>must</b> use Schedule C. Enter on both Form 1040, line 12, and Schedule SE, line 2, or on Form 1040NR, line 13 and Schedule SE, line 2, (see instructions). (Statutory employees <b>do not</b> report this amount on Schedule SE, line 2.) Estates and trusts, enter on Form 1041, line 3 .....	<b>3</b>	673

Tessa is eligible to file the short Schedule SE. She owes \$95 in self-employment tax to pay for Social Security and Medicare. Half of her self-employment tax (\$48) is an adjustment (a reduction) to her income that we'll see on page one of her Form 1040, Schedule 1 Line 14.



**Form 1040** Department of the Treasury—Internal Revenue Service (99) **2019** U.S. Individual Income Tax Return OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

**Filing Status**  Single  Married filing jointly  Married filing separately (MFS)  Head of household (HOH)  Qualifying widow(er) (QW)  
 Check only one box. If you checked the MFS box, enter the name of spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent. ▶

Your first name and middle initial <b>Tessa</b>	Last name <b>Tutor</b>	Your social security number
If joint return, spouse's first name and middle initial <b>Husband</b>	Last name	Spouse's social security number
Home address (number and street). If you have a box, see instructions.		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).		<input type="checkbox"/> <b>Presidential Election Campaign</b> Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. <input type="checkbox"/> <b>You</b> <input type="checkbox"/> <b>Spouse</b>
Foreign country name	Foreign province/state/county	Foreign postal code
If more than four dependents, see instructions and ✓ here <input type="checkbox"/>		

**Standard Deduction** **Someone can claim:**  You as a dependent  Your spouse as a dependent  Spouse itemizes on a separate return or you were a dual-status alien

**Age/Blindness** **You:**  Were born before January 2, 1955  Are blind **Spouse:**  Was born before January 2, 1955  Is blind

<b>Dependents (see instructions):</b>		(2) Social security number	(3) Relationship to you	(4) ✓ if qualifies for (see instructions):	
(1) First name	Last name			Child tax credit	Credit for other dependents
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>

**Standard Deduction for—**  
 • Single or Married filing separately, \$12,200  
 • Married filing jointly or Qualifying widow(er), \$24,400  
 • Head of household, \$18,350  
 • If you checked any box under **Standard Deduction**, see instructions.

<b>1</b> Wages, salaries, tips, etc. Attach Form(s) W-2	<b>1</b>	<b>55000</b>
<b>2a</b> Tax-exempt interest	<b>2a</b>	
<b>3a</b> Qualified dividends	<b>3a</b>	
<b>4a</b> IRA distributions	<b>4a</b>	
<b>c</b> Pensions and annuities	<b>4c</b>	
<b>5a</b> Social security benefits	<b>5a</b>	
<b>b</b> Taxable interest. Attach Sch. B if required	<b>2b</b>	
<b>b</b> Ordinary dividends. Attach Sch. B if required	<b>3b</b>	
<b>b</b> Taxable amount	<b>4b</b>	
<b>d</b> Taxable amount	<b>4d</b>	
<b>b</b> Taxable amount	<b>5b</b>	
<b>6</b> Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	<b>6</b>	
<b>7a</b> Other income from Schedule 1, line 9	<b>7a</b>	<b>673</b>
<b>b</b> Add lines 1, 2b, 3b, 4b, 4d, 5b, 6, and 7a. This is your <b>total income</b>	<b>7b</b>	<b>55673</b>
<b>8a</b> Adjustments to income from Schedule 1, line 22	<b>8a</b>	<b>48</b>
<b>b</b> Subtract line 8a from line 7b. This is your <b>adjusted gross income</b>	<b>8b</b>	<b>55625</b>
<b>9</b> <b>Standard deduction or itemized deductions</b> (from Schedule A)	<b>9</b>	<b>24000</b>
<b>10</b> Qualified business income deduction. Attach Form 8995 or Form 8995-A	<b>10</b>	<b>135</b>
<b>11a</b> Add lines 9 and 10	<b>11a</b>	<b>24135</b>
<b>b</b> <b>Taxable income.</b> Subtract line 11a from line 8b. If zero or less, enter -0-	<b>11b</b>	<b>31490</b>

Form 1040 (2019) Page **2**

<b>12a</b> Tax (see inst.) Check if any from Form(s): 1 <input type="checkbox"/> 8814 2 <input type="checkbox"/> 4972 3 <input type="checkbox"/>	<b>12a</b>	3396
<b>b</b> Add Schedule 2, line 3, and line 12a and enter the total	<b>12b</b>	3396
<b>13a</b> Child tax credit or credit for other dependents	<b>13a</b>	4000
<b>b</b> Add Schedule 3, line 7, and line 13a and enter the total	<b>13b</b>	4000
<b>14</b> Subtract line 13b from line 12b. If zero or less, enter -0-	<b>14</b>	0
<b>15</b> Other taxes, including self-employment tax, from Schedule 2, line 10	<b>15</b>	95
<b>16</b> Add lines 14 and 15. This is your <b>total tax</b>	<b>16</b>	95
<b>17</b> Federal income tax withheld from Forms W-2 and 1099	<b>17</b>	
<b>18</b> Other payments and refundable credits:		
<b>a</b> Earned income credit (EIC)	<b>18a</b>	
<b>b</b> Additional child tax credit. Attach Schedule 8812	<b>18b</b>	604
<b>c</b> American opportunity credit from Form 8863, line 8	<b>18c</b>	
<b>d</b> Schedule 3, line 14	<b>18d</b>	
<b>e</b> Add lines 18a through 18d. These are your <b>total other payments and refundable credits</b>	<b>18e</b>	604
<b>19</b> Subtract line 18e from line 16. Enter the result. If zero or less, enter -0-	<b>19</b>	509
<b>20</b> Amount you owe. Subtract line 19 from line 16. For details on how to pay, see instructions	<b>20</b>	509
<b>21</b> Estimated tax paid during the year	<b>21</b>	509
<b>22</b> Amount of line 20 you want applied to your 2020 estimated tax	<b>22</b>	
<b>23</b> Amount you owe. Subtract line 19 from line 16. For details on how to pay, see instructions	<b>23</b>	
<b>24</b> Estimated tax penalty (see instructions)	<b>24</b>	

**Third Party Designee**  
Do you want to allow another person (other than your paid preparer) to discuss this return with the IRS? See instructions.  Yes. Complete below.  No

**Sign Here**  
Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)

**Paid Preparer Use Only**

Preparer's name	Preparer's signature	Date	PTIN	Check if: <input type="checkbox"/> 3rd Party Designee <input type="checkbox"/> Self-employed
Firm's name	Firm's address	Phone no.	Firm's EIN	

Go to [www.irs.gov/Form1040](http://www.irs.gov/Form1040) for instructions and the latest information. Form **1040** (2019)

## Finding a Local Tax Professional

I hope these examples are helpful, but **your tax return will look different!**

If you have questions or concerns about the accuracy of your tax return, I recommend you contact a local tax professional, either an Enrolled Agent or a CPA. The employees of storefront tax preparation services are not well-equipped to prepare business tax returns; they are trained to prepare simple individual income tax returns. As a business owner, your taxes are significantly more complicated (even if your income is not large), and you need professional, qualified assistance.

To find a local tax professional, I recommend two sources:

- QuickBooks Pro Advisor at <https://quickbooks.intuit.com/find-an-accountant>
- Dave Ramsey Endorsed Local Provider at <https://www.daveramsey.com/elp/tax-advisor>

Both of these websites allow you to search for a local tax preparer who is knowledgeable about taxes for small sole proprietor businesses. Look for the enrolled Agent (EA) or Certified Public Accountant (CPA) designation.

## Questions and Answers

Q: How much can I expect to pay for a tax professional to prepare my tax return?

A: Prices vary by geography and with each form. According to the National Association of Tax Professionals, the average price charged by CPAs is \$213 for a personal tax return in the 2019 tax season. Add on a business (Schedule C) and expect to pay an additional \$84 (in 2019).<sup>4</sup>

Q: I'm a teacher at a homeschool program that my children attend. My 1099-MISC includes more than I was paid. When I asked why, I was told it was for my child's "free" tuition. They didn't charge me for one of my three children because I was a teacher. Is that correct?

A: Since you were given a 1099-MISC (it will be a 1099-NEC beginning in tax year 2020), I am assuming that you were hired to teach as an independent contractor, not as an employee. Your free tuition, an educational benefit, is considered taxable compensation (educational benefits are a form of taxable compensation). An independent contractor is not supposed to receive any fringe benefits such as free or reduced tuition. So your "free" tuition must be added to your 1099-MISC nonemployee compensation and you will pay income tax on that compensation.

Employees of qualified educational institutions can receive tuition discounts and educational benefits tax-free. It is one of the perks of being an employee. For more details, consult my book *Paying Workers in a Homeschool Organization*.

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<sup>4</sup> Source: <https://www.natptax.com/explore/Documents/2019-NATP-FeeStudy.pdf>

## Chapter 7 Paying Yourself

Melissa and I were discussing her homeschool business. She had agreed to become a Classical Conversations® director. She explained how she paid herself. “I taught a group of students one day a week and my hired tutor taught another group at the same time. I gave her a 1099-MISC and I gave myself one for the same amount since we worked the same hours. I reported that 1099-MISC on my tax return.” Her explanation sounded reasonable, but it was not the correct way for Melissa to report her income and expenses on her tax return or to pay herself.

A sole proprietor should *not* give him or herself a W-2 (the form given to employees reporting their income earned in a year) or a 1099-MISC or 1099-NEC<sup>5</sup> (a form reporting to independent contractors what they earned last year). A sole proprietor is *not* an employee nor an independent contractor of her own business.<sup>6</sup>

Melissa incorrectly under-reported her income on her tax return. She should have reported all the payments she received from her parent-customers, not just what she claimed that she earned by teaching a class. I explained that the IRS does not look kindly on under-reporting income. It’s called fraud! I advised Melissa to hire a professional to amend her tax return and report *all* her income, not just the (incorrect) 1099-MISC income. The tax professional will also help her correct the 1099-MISC she gave herself.

### How Does a Business Owner Get Paid?

“So how do I get paid?” Melissa asked.

Good question! “You get to keep the profits,” was my reply. That’s how small business owners get paid: they keep the profit for themselves.

Typically, a business owner transfers money out of her business checking account and deposits it into her personal checking account and then uses it for personal expenses. This transfer of

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<sup>5</sup> Beginning in tax year 2020, Non-employee Compensation will be reported on Form 1099-NEC, not Form 1099-MISC.

<sup>6</sup> The tax rules are different if your business is a corporation. Then the owner *does* take a salary (and gets a W-2) from the corporation. Most homeschool business owners do not organize their businesses as corporations because it is overly complex.

money is called an “owner’s draw.” An owner’s draw involves drawing some of the profits out of the business checking account<sup>7</sup> and transferring the money into the owner’s personal account.

This owner’s draw is the closest thing a sole proprietor comes to getting a paycheck, but it is not a salary or wages. It is simply a transfer of money between checking accounts.

One of my tax clients, Kevin, did not understand how he as a small business owner was paid. He was a highly compensated independent contractor. When I prepared his tax return and gave him the bad news about what he owed in taxes, he asked, “Didn’t you deduct the money I paid myself?” “No,” I replied, “Those are owner’s draws, not a salary and not a tax deduction.” I went on to explain that he had to pay tax on his *profits*, not what cash he left in the business checking account. Kevin had a lot of profit and therefore owed a lot of tax.

There is no tax deduction for any so-called salary a sole proprietor pays herself. I don’t even want you to think of your owner’s draws as a salary you pay yourself. Think of it as a transfer of the profits out of your business.

When you make a draw of money out of your business, do not report it as a business expense. It’s not an expense. Instead, record it in your checkbook and accounting software with a notation: “Owner’s draw.” You can make a note of it on your bookkeeping spreadsheet if you wish, but do not record it on your tax return as a business expense.

Please be very cautious about making owner’s draws out of your business checking account. You need to leave enough money in your business checking account to pay future business expenses. I have created a bookkeeping spreadsheet that will help you monitor your profits as you progress through the year. It is available at [HomeschoolCPA.com/Spreadsheet](http://HomeschoolCPA.com/Spreadsheet).

## Questions and Answers

Q: Will I have to pay taxes twice? First, taxes paid by the business and then taxes paid by me again when I draw it out from the business and put it into my personal account?

A: No, you will not pay taxes twice. The IRS does not tax the transfer of your money; they tax the profits of the business as shown on Schedule C. The owner’s draws that you make do not show up on your tax return. Only the income, expenses, and the profit is shown on the tax return. So you will not pay taxes twice.

Here’s an example:

Business income for the year: \$8,000

Expenses for the year: \$6,000

Net Income (i.e., profit) \$2,000 (\$8,000 - \$6,000)

Tax is paid on the \$2,000 profit.

If you withdraw (as an owner’s draw) \$1,800 of the \$2,000 profit, it is not a business expense or a tax deduction. It is not a salary. It is simply a transfer of money from one checking account into another. You still pay tax on the \$2,000 profit.

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<sup>7</sup> Opening a business checking account for your business separate from your personal checking account is a good business practice.

## Chapter 8: Paying Workers, Tutors, and Teachers

Paying tutors, teachers, and other workers in your homeschool business can be complex and confusing. As a business owner you have two choices: you can pay a worker as an employee or as an independent contractor. Volunteers are not permitted in for-profit businesses. See the Q&A at the end of this chapter.

It is tempting to pay workers as independent contractors since the taxes and paperwork is less complex and less expensive than hiring an employee, but the IRS states that the facts and circumstances of each situation determine a worker's status, not your desire to cut expenses or simplify your life.

### Supervision and Control of Teachers and Tutors

My book *Paying Workers in a Homeschool Organization* covers payroll forms, employer taxes, and worker determination in detail. I highly recommend that you purchase this book if you pay either independent contractors or employees. It is available at [HomeschoolCPA.com](http://HomeschoolCPA.com). The book goes into a lot of details on the factors you need to consider in order to classify a worker as an employee or as an independent contractor. But I want to emphasize the bottom line and then you can dive into the details, keeping in mind your specific situation.

**Your business's right of supervision and control over the worker is the critical issue.**

The IRS has several factors to consider when making a worker determination. The three categories of factors include: behavioral control, financial control, and the relationship of the parties. The specific factors are tools to uncover evidence of supervision and control or lack of control. Always focus your attention on the supervision and control factors.

Since teachers and tutors in a homeschool program are working closely with children, it is expected that you as the owner will exert significant control and supervision over the teachers in order to help ensure the children's safety. If your group has behavioral, moral, or spiritual guidelines that you wish teachers to follow because they are examples to the children they teach,

you are exerting significant control and supervision over them. According to Bertrand M. Harding, an attorney and author of *The Tax Law of Colleges and Universities*, IRS agents have determined that:

“Because instruction is such a basic and fundamental component of a college or university, individuals who are hired to provide instruction should always be treated as employees because the school is so interested and involved in what they do that it will always exercise direction and control over their activities.”<sup>8</sup>

I feel confident in saying that the same is true for homeschool programs. **Because instruction is a fundamental component of a homeschool program, instructors, tutors, and teachers should be treated as employees because the homeschool business owner will always exert control over these workers.**

## Hiring Workers to Provide the Key Activity of Your Business

Another critical factor that the IRS and many states use to determine whether a worker is an employee or independent contractor is whether the worker is providing the key activity of the business. Teachers and tutors provide the key activity in most homeschool programs. You would not have a homeschool program or CC Community without them! That is why teachers and tutors should be paid as employees.

This factor was one of the three crucial tests for independent contractor status in the “ABC Test” used by the California Supreme Court in the *Dynamex* ruling and recently made into law in California as well. Employers must be able to answer yes to all three parts of the ABC test if they want to classify workers as independent contractors:

- A: The work must be free from the control and direction of the company in connection with the performance of the work, both under the contract for performance of the work and in fact;
- B: The worker performs work that is outside the usual course of the company’s business; and,
- C: The worker is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the work performed.

The B test means that the worker who performs work *outside* the usual course of the business could be an independent contractor (if they meet the requirements of the other two tests). This might be true for your bookkeeper, CPA, attorney, graphic designer etc. While this ABC test is now the law in California, over 20 states have some aspect of the ABC test in their laws as well. It is a strict but safe guideline to follow.

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<sup>8</sup> Harding, Bertrand M. *The Tax Law of Colleges and Universities* Third Edition, Wiley, 2008.

## Risks and Consequences of Worker Misclassification

You may be wondering about the risks and consequences of getting caught misclassifying your workers and tutors and how the IRS would even know what you're doing.

The IRS can initiate a worker classification investigation of a business based on five triggers:

1. Randomly selected for investigation
2. The IRS seeing many 1099-MISC forms instead of W-2 forms being filed by a business
3. A worker applying for worker's compensation or unemployment with his or her state government who then shares this information with the IRS
4. A worker requesting the IRS review his or her status using Form SS-8
5. A worker stating on his or her tax return that he or she should be an employee by filing a Form 8919

I've seen all of these triggers occur, including some to homeschool organizations. One homeschool business owner felt she knew her tutors well and was confident that they would not submit an SS-8 to the IRS, but the IRS takes worker misclassification very seriously and has five ways to initiate an investigations, only two of which are initiated by the worker.

The consequences of misclassifying your workers can be significant. One expert calculated that a business may spend 40% of the contractors' annual pay in penalties alone,<sup>9</sup> and the IRS can assess penalties for three prior years. Under Internal Revenue Code section 3509, the taxes include: paying a portion of federal income tax, FICA (Social Security tax), and Federal unemployment compensation taxes (FUTA). Additionally, there are penalties for missed deposits, a \$50 penalty for each Form W-2 that the employer failed to file, and a penalty for failure to pay taxes of 0.5% of the unpaid tax liability for each month up to 25% of the total tax liability.

## IRS Relief Programs

The IRS fees and penalties mentioned above can add up. Fortunately, the IRS offers two relief provisions:

- Section 530 of the Revenue Act of 1978 called the Safe Harbor provision
- Voluntary Classification Settlement Program (VCSP), frequently called an amnesty program

The Safe Harbor provision offers relief from all penalties and back taxes, but you must meet specific criteria to be eligible. In particular, you must have been filing 1099-MISC forms and have a *reasonable basis* for treating your workers as independent contractors. Read IRS Publication 1976 for details on what constitutes a reasonable basis (available at <https://www.irs.gov/pub/irs-pdf/p1976.pdf>).

The Voluntary Classification Settlement Program (VCSP) is an amnesty program that allows employers to apply *before they are audited* and pay only a small fraction of the employment tax liability owed (10 percent). This amnesty program requires that you convert all misclassified independent contractors to employees. Read the IRS webpage for details about the VCSP

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<sup>9</sup> "Fines and Ramifications" Net Polarity <http://www.netpolarity.com/fines-and-ramifications.html>

<https://www.irs.gov/businesses/small-businesses-self-employed/voluntary-classification-settlement-program>. I can help you determine if either of these programs are applicable to you. Contact me by e-mail at [Carol@HomeschoolCPA.com](mailto:Carol@HomeschoolCPA.com).

## Using a Payroll Service

You are probably now convinced that you should treat your workers as employees. You will have a lot to learn, so I recommend that you purchase my book *Paying Workers in a Homeschool Organization*. It's a good primer and overview of hiring and paying all types of workers. If you need help with payroll, please visit [HomeschoolCPA.com/Bookkeepers](http://HomeschoolCPA.com/Bookkeepers). It will refer you to bookkeepers and payroll consultants who are very familiar with homeschooling (most are homeschool moms!).

## Questions and Answers

Q: I'm a CC Director and I hired one tutor. I tutor one class; she tutors the other. I gave her a 1099-MISC and gave myself one too. Was that correct?

A: No, it was not correct. As a business owner (I'm referring to a sole proprietorship filing a Schedule C on their Form 1040), a CC Director is not paid as an independent contractor. Business owners are not "paid" at all. Instead, they get to keep all the profit that the business makes. (See Chapter 7 "Paying Yourself" for how to correctly report your earnings from your CC business.)

As the business owner, you should have reported on your Schedule C (see Chapter 4). *all the income that the participating families paid you*. That amount is your total income, not what you "paid yourself" and reported on a 1099-MISC (incorrectly). To correct your prior year tax return, contact a local CPA to help you file a Form 1040X Amended Tax Return.

Q: If I have a written and signed an agreement with my independent contractor, won't I be okay treating her as independent contractor since we both agree on that status?

A: Unfortunately, you are not "okay" simply by having your worker agree to be an independent contractor. Such agreements carry little, if any, weight with the IRS, Department of Labor, or state governments. If your actions show an employee relationship, then your worker is an employee regardless of what you call her or any signed agreement. In other words, actions speak louder than written or spoken words.

Q: The worker I hired wants to be treated as an independent contractor. Is that good enough basis to treat him like an independent contractor?

A: No. You cannot assume it is safe to classify a worker as an independent contractor simply because the worker wants, or asks, to be treated as an independent contractor. Your relationship and behavior count more than the worker's desires.

Q: Are Classical Conversations® (CC) tutors employees or independent contractors? As a CC Director I have all my tutors sign an agreement to be independent contractors.

A: Having a contract is not assurance that a tutor is an independent contractor; how they are treated and your right of supervision and control over him or her is the determining factor. From what I have seen and know of CC tutors, they are highly supervised, and their methods of teaching are closely controlled. That could cause the IRS to determine that CC tutors are employees.

Q: What if the parents pay the teachers directly? Can I still have the teachers sign an agreement?

A: If the parents pay the teachers, then your homeschool business does not have a legally binding contract with the teachers. In order for a contract to be legal, proper, and binding there has to be the exchange of money (or property). In legal terms, this transfer of money is called “consideration.” Since your business is not paying the teachers, there is no “consideration” and therefore no legal contract.

Instead, you could create a Memorandum of Understanding (MoU) with each teacher. In the MoU you could state, “If you want to use our space to teach your class, you need to understand these items ...” A MoU is not legally binding, but it is a tool of communication between you and the teachers. There is a sample Memorandum of Understanding in my book *Paying Workers in a Homeschool Organization*.

Q: I have several parents and teenagers that volunteer in my homeschool theater program, especially on performance nights. Can my business have volunteers?

A: No, a for-profit business cannot have volunteers. You must pay these workers as employees.

According to The HR Daily Advisor<sup>10</sup> “most for-profit businesses cannot accept volunteer, unpaid labor without running afoul of the Fair Labor Standards Act (FLSA)” which sets minimum wage and overtime laws. Typically, the only time volunteer labor is allowed is when the organization is a nonprofit organization such as a church, a community service organization, or a charity. The Department of Labor website states, “Under the FLSA, employees may not volunteer services to for-profit private sector employers.”<sup>11</sup> .

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<sup>10</sup> “Can You Accept Volunteer Labor?” Bridget Miller <https://hrdailyadvisor.blr.com/2018/01/04/can-accept-volunteer-labor/> Accessed Oct 3, 2019

<sup>11</sup> “Volunteers” <https://webapps.dol.gov/elaws/whd/flsa/docs/volunteers.asp>. Accessed Oct 3, 2019

## Chapter 9: Church Use by Businesses

Many homeschool groups use churches for their educational programs. These homeschool groups are grateful to the churches for allowing homeschoolers to use their building, sometimes without charging rent. But for homeschool programs that are for-profit businesses, operating in a church could threaten the church's property tax exemption. Churches are granted property tax exemption by their states for conducting religious activities or worship services. In most states, a church cannot let their building be used for activities with a "view to profit" or for "pecuniary gain" (gain of monetary value). If they do so, the church could lose part or all of its property tax exemption.

Your for-profit business meeting in a church can negatively impact the church's property tax exemption and can cost them thousands of dollars each year. Many homeschool businesses, CC Communities in particular, have found themselves uninvited from their church host. This is very unfortunate, but it is the church's responsibility to guard their property tax exemption by obeying the laws of their state regarding church property use.

### Property Tax Versus Income Tax

Use of church property by a for-profit business affects state *property tax exemption* but does not affect the church's *federal income tax exempt* status as a 501c3 organization. Those are two different taxes and are assessed differently. Property tax exemption is based on the use of the building. Federal income tax is based on income from activities related to the church's exempt purpose (religion).

### Can't a Business Have a Religious Purpose?

Some homeschool business owners believe that their businesses have a religious purpose. They tell me that they are Christians, pray before classes, quote Bible verses, etc., hoping that these criteria fit the religious purposes of the church. Unfortunately, the religious faith of the owner or conducting religious activities such as prayer, Bible teaching, etc. does not mean a business has an exempt religious *purpose*. As the owner of a for-profit business, your purpose is to make a profit.

I have heard vigorous defense that some homeschool business are so steeped in the Christian faith that using a church building actually helps promote the church's mission. Some even call Christian education "worship." While Christian education may enhance the church's religious purpose, the fact still remains that many states deny property tax exemption to the church if a for-profit business (regardless of its religious nature) uses the building. Additionally, many state statutes regarding property tax exemption are specific on what type of entities can claim the religious exemption. They usually only offer property tax exemption if the organization using the property is a nonprofit with a religious purpose. These states, such as Illinois, have specific restrictions against pecuniary (relating to or consisting of money) use.

Whether a business can have a religious purpose for property tax exemption will be decided by local tax assessors and perhaps the courts of law in each state. Practically, it is doubtful that churches hosting homeschool programs are willing to pursue this issue in the courts. Legal bills will mount, and the likelihood of the church losing its case is getting stronger as more states limit property tax exemption on churches and other houses of worship. It is just easier and less costly for a church to deny the use of the church property to for-profit businesses.

Additionally, many churches have a distaste to making their space a "marketplace." These churches may have a policy against church property being used by for-profit businesses because it reminds them of Jesus driving the money changers out of the temple. Even if state laws allow some insubstantial for-profit activity on church property, the church may have its own policy on the uses of its buildings. It is polite and honorable to clearly explain to the church that your business is a for-profit business owned by you and ask if they have any policies objecting to for-profit use of the church property.

### Not Paying Rent Doesn't Help Your Church Host

Some homeschool business owners believe that if their church host does not charge them rent, they can continue to meet on the church property without incurring any tax issues for the church. But property tax concerns itself with the property *use*, rather than rental *payments* (income tax concerns itself with rental payments). So the fact that your business may not pay rent to the church does not change the fact that the church is letting a business use its property. Depending on your state law, the county tax assessor could charge the church full or partial property tax.

One homeschool business owner (who does pay rent to the church) was offered an opportunity to use a third party (a nonprofit with 501c3 status called Followers in Fellowship) to collect the rent and then pay the rent to the church. In this arrangement it would appear that the nonprofit (with 501c3 status) would be renting the space and, therefore, helping to maintain the church's property tax exempt status. It's an interesting idea, but the issue is not the rental payments, it is *building use*. The for-profit homeschool business is still the one using the church building! The practice appears to be an attempt to hide the real use of the church property. The business owner declined to participate. Instead, she is considering reorganizing as a nonprofit

organization as the church encourages. See Chapter 10 “Should My Homeschool Program be a Nonprofit?”

If a church rents its property to a for-profit business, the church may end up owing both property tax *and* federal income tax (called unrelated business income tax), respectively. Try not to be confused by the types of taxes a church may have to pay. Property tax is different from federal income tax. These are two different taxes with different tax bases. Property tax is assessed based on the building’s use while federal income tax is based on the sources of income. The taxes are assessed differently

### Property Tax State Laws Vary

Property tax laws and exemptions are determined by each state and administered and assessed by a county tax assessor (or sometimes the state revenue department). In some states and counties, the property tax laws are more forgiving than in others. Become informed about the limits on business activities conducted by churches in your state’s property tax exemption laws. This document may help you start your research: <https://www.civiced.org/file/4794/download?token=3ifCi8dl>. The .pdf file is 466 pages and lists the state statuses for every state. Since the document is about 20 years old, you should then do an internet search “[YOUR STATE] nonprofit property tax exemption” or “[YOUR STATE] church property tax exemption.” Get the latest information on any changes in your state’s property tax exemption guidelines and laws.

The only certain way to know what the church’s property tax bill might be is to call the government agency responsible for assessing property tax, usually the local county property tax assessor. Ask the person with the knowledge and authority to assess property tax, “Can a church let a for-profit business use the church’s building on a regular basis without harming the church’s property tax exemption?” Ask for an assessment to be conducted and an estimate of the property tax to be calculated. Request a *written* report of their findings and opinion, especially if the county tax assessor declares there is “no problem.” Determine if your business or the church can afford to pay the property tax bill. Be aware that some states, but not all, may allow a partial property tax assessment based on amount of space and frequency of use.

One homeschool business owner (a CC Director) was grateful when her local property tax assessor declared that her homeschool business use was “too small to worry about.” This indeed is a generous tax assessor! As she shared her joyous news on social media, another CC Director in the same state but a different county got very different news from her tax assessor. The church learned they were facing a property tax bill and asked the CC Community to leave. Lesson learned: property tax laws vary by state and county.

### What Can a Business Owner Do?

- Talk to your host church about this issue. Ask if they have any policies about businesses using the church. Ask what they know about limits on business activity for churches in your state. Be up front and honest. If you have not clearly explained that your homeschool

program is a for-profit business, do that now. Failure to disclose this to your church host and calling yourself “just a bunch of homeschool moms” or “a ministry to homeschool families” borders on deceit. Many CC Communities found themselves kicked out of churches for their lack of honest clarity on the true nature of their businesses.

- You or the church should call your local property tax assessor and discuss the matter. The assessor may want to conduct a site visit and will ask many questions about the amount of space used and the frequency of use.
- Do not reply on vague promises of “the church’s lawyers said we’re fine” or “Alliance Defending Freedom (ADF) (a nonprofit organization that defends religious freedoms) will represent us or the church if we are sued.” Instead, ask for a lawyer’s assessment of your particular situation *in writing* on their letterhead. Call ADF and ask if they will defend a church or a business owner in a tax issue (their website says they will not).<sup>12</sup>
- Consider looking for a location that is not a church, library, or other location with property-tax-exempt status. In other words, rent commercial space.
- Consider converting your business to a nonprofit organization with a religious and educational purpose. That involves forming a board to operate the program, drafting bylaws, etc. It takes time and money, but then the nonprofit organization could use the church’s space without being concerned about threatening the church’s property tax exemption. See Chapter 10 “Should My Homeschool Program Be a Nonprofit?” for details.

For information on what a church should do, visit this [FAQ page \(http://homeschoolcpa.com/faq-on-property-tax-for-churches-hosting-homeschool-programs/\)](http://homeschoolcpa.com/faq-on-property-tax-for-churches-hosting-homeschool-programs/) to better understand the implications on the church.

## Questions and Answers

Q: What if the church knows I’m operating a for-profit business and doesn’t mind or doesn’t care?

A: It is quite rare for a church to knowingly allow a for-profit business to use their facilities. The church is putting itself at risk of losing part or all of its property tax exemption. The church may be ignorant of their state’s prohibition against using their tax-exempt property to conduct for-profit activities. Or you may have misrepresented the true nature of your business. Or you may have spoken with a pastor and not the church’s business administrator or board of trustees, who are more aware of the legal and financial matters of the church.

Q: Isn’t it the responsibility of the church to ask if my homeschool program is a for-profit business?

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<sup>12</sup> “ADF does not provide legal representation for the following: Tax advice, tax audits or investigations that do not relate to religious liberty; ... Land use cases will generally only be approved if discrimination or unequal treatment is present.” <https://www.adfchurchalliance.org/benefits>. Accessed October 21, 2019

A: It is quite unusual for a church to let a for-profit business use their facilities, so they may not have even thought of asking if your homeschool program was a business. You bear responsibility for disclosing the true nature of your business to the church. If the church is made aware of the for-profit nature of your homeschool program, it reflects badly on you and all homeschoolers. You may find yourself financially liable for part or all of the church's property tax bill. That is a risk you are unlikely to take, so have an open, honest discussion with your church host now.

Q: My church houses a bookstore/coffee shop/Weight Watchers, etc.? How is that legal but my religious homeschool program is not?

A: These examples may be for-profit businesses operating in a church and may threaten the property tax exemption of the church. Alternately, the church may be paying property tax on the portion of the building being used by the businesses (if their state allows partial nonexempt use).

Q: How do I know what my state laws say about property tax exemption for churches?

A: Do an internet search on property tax exemption and your state. This pdf file (466 pages long) from The Civic Federation may help: <https://www.civiced.org/file/4794/download?token=3ifCi8dl>. It lists the property tax laws for each state. After you do a search for state laws, call your local county tax assessor. The state sets the laws, but the local assessor applies the law to specific situations. Ask the assessor about business use of a church's building affecting property tax exemption.

Q: I heard that some anti-homeschoolers sent letters to churches scaring them about this issue. The fearmongering resulted in some churches kicking out CC Communities. Did you send the letters?

A: I did not send the letters, nor do I know who sent the letters. I am not one of the "Concerned Christian Citizens" who signed the letter, nor do I know who they are.

Two of my blog posts were referenced in the letter. These blog posts were dated months or years before the letters were mailed (April 2019) and were available for everyone to read. In other words, my referenced information has long been available. I had no reason to send the letters. It has not helped me, my business, or my reputation.

## Chapter 10: Should My Homeschool Program Be a Nonprofit?

I've received many emails from homeschool leaders like this one:

I have a neat idea for a much-needed homeschool hybrid program in my city. I have three other moms willing to help. I am trying to decide if I should start my homeschool hybrid as an LLC or a nonprofit. Can you help?

My reply was to say, "You can choose your business type including for-profit LLC or nonprofit status." There are advantages and disadvantages to each option. Historically, most homeschool programs are nonprofit organizations, but more for-profit businesses, especially Classical Conversations® Communities, are serving homeschoolers. In this chapter I will discuss the differences between operating a nonprofit and a business. I will also explain how to convert a for-profit business to a nonprofit organization.

### What's the Difference Between For-Profit and Nonprofit?

The main differences between a for-profit business and a nonprofit organization are:

- Purpose and motive—A for-profit business, by definition, has making a profit as its purpose.<sup>13</sup> Nonprofits have a purpose other than making a profit. In the case of a nonprofit homeschool program the purpose would be education.
- Ownership and control—A nonprofit is not owned by anyone; the Board of Directors runs everything. The Board also hires and fires all workers, including the founder or (former) owner of the business. A business owner who converts to a nonprofit surrenders her control of the business to the Board.
- Tax exemption and tax deductible donations—Nonprofits who apply for 501(c)(3) status with the Internal Revenue Service (IRS) will be tax exempt on their surplus (profit) and can receive tax-deductible donations. For-profit businesses pay income tax on their profit and cannot receive tax deductible donations.

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<sup>13</sup> Definition of for-profit: "established, maintained, or conducted for the purpose of making a profit." <https://www.merriam-webster.com/dictionary/for-profit>. Accessed October 25, 2019

If you want to create a nonprofit organization, my book *The IRS and Your Homeschool Organization: Tax Exempt 501(c)(3) Status* will be very helpful to you. It is available at [HomeschoolCPA.com/Bookstore](http://HomeschoolCPA.com/Bookstore). I also offer private phone consultations to help homeschool business owners determine if re-forming as a nonprofit organization is the best option for them.

I created a webinar titled “Create a Nonprofit for Your Homeschool Community” that may be helpful. I had in mind business owners who want to convert their business to a nonprofit when I recorded the webinar. Purchase the recording of the webinar at [HomeschoolCPA.com/CreateNP](http://HomeschoolCPA.com/CreateNP).

## Tax Exempt Status

Many homeschool leaders are confused by the words “nonprofit” and “tax exempt.” They are not quite the same thing but they frequently go hand-in-hand. Nonprofit is a status conferred by state law for organizations that are organized and operate as nonprofits. Tax exempt status is conferred by the United States Internal Revenue Service to qualified nonprofit organizations, granting them freedom from federal income tax. Almost always, nonprofit organizations immediately apply for tax exempt status with the IRS after receiving nonprofit status in their state.

501(c)(3) is a tax exempt status granted by the IRS to qualified nonprofit organizations whose purposes include charitable, religious, or educational purposes (and a few other purposes). Tax exempt status for 501(c)(3) organizations is not automatically granted just because your organization is a nonprofit; it must be applied for with the IRS.

## Advantages of Tax Exempt Status

There are several benefits of 501(c)(3) tax exempt status. By far the most valuable benefit is the exemption from paying federal income tax on your financial surplus. Additionally, many organizations consider the ability to provide a tax deduction to donors for their contributions as a significant benefit. Other benefits include prestige, discounts on insurance, and participation in special programs such as Box Tops for Education, which is only open to nonprofits with 501(c)(3) tax exempt status.

Recently, many homeschool businesses, especially CC Communities, are finding that churches are more willing to offer them a place to meet if they are formed as nonprofit organizations rather than as for-profit businesses. The churches fear that their property tax exemption may be threatened by granting space to for-profit businesses.<sup>14</sup> As a nonprofit organization, a CC community or homeschool program can come into alliance with the church’s religious and educational purpose and not threaten their property tax exemption. See Chapter 9 “Church Use by Businesses” for more information.

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<sup>14</sup> For more information, visit “FAQ on Property Tax for Churches Hosting Homeschool Programs” at <http://homeschoolcpa.com/faq-on-property-tax-for-churches-hosting-homeschool-programs/>.

## Disadvantages of Tax Exempt Status

The application for tax exempt status involves filing an IRS application form, either the Form 1023 or the shorter online 1023-EZ and paying the IRS fee of \$275-\$600 based on the size of your organization.

If the new nonprofit is a “successor” to a for-profit entity, you are ineligible to use the shorter Form 1023-EZ; you’ll have to file the longer Form 1023 and explain your history and reasons for the conversion to the IRS. The IRS defines a successor as “substantially taking over all of the assets or activities of a for-profit entity.”<sup>15</sup> It’s not impossible to convert to a nonprofit and be granted tax exempt status. I’ve helped several homeschool businesses do this, but it does take longer and will cost more. I recommend that you get experienced professional assistance in preparing the Form 1023 application. My website has several resources to help you apply for 501(c)(3) status at [HomeschoolCPA.com/services/501c3-tax-exempt-status/](https://HomeschoolCPA.com/services/501c3-tax-exempt-status/).

Also required is an annual report to the IRS called the IRS Form 990/990-EZ or the short ePostcard Form 990-N. Each state typically has required reports from nonprofit organizations as well.

Another disadvantage to 501(c)(3) status is that 501(c)(3) organizations cannot endorse a candidate for political office.

To best understand the advantages and disadvantages of seeking 501(c)(3) tax exempt status, please consult an experienced professional. I offer phone consultations to homeschool leaders at [HomeschoolCPA.com/services/consultation](https://HomeschoolCPA.com/services/consultation).

## How to Convert a Business to a Nonprofit Organization

The stages to help you convert to a nonprofit organization and apply for tax exempt status are grouped into three main tasks: setting up the organization and forming a nonprofit corporation, applying for tax exempt status, and state-required filings.

### Setting Up Your Nonprofit Organization

1. Choose a name for your nonprofit organization.
2. Choose a Board of Directors. Usually three people are needed: a president/chair, a treasurer, and a secretary. These people should be unrelated to you as the former business owner and to each other. The board should also not have been paid by you or by the nonprofit. Instead, they should serve as volunteer board members to avoid a conflict of interest. Volunteer parents are good candidates for board members.
3. Create bylaws. These are the rules by which you will operate. You can find sample bylaws at [HomeschoolCPA.com/Samples](https://HomeschoolCPA.com/Samples).

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<sup>15</sup> Eligibility Worksheet, IRS Instructions to Form 1023-EZ.

Forming a Nonprofit Corporation (Optional, but highly recommended).

4. Create Articles of Incorporation. Many states have a specific form to use for this. Include in your Articles of Incorporations IRS-required language on your purpose, limitations, and distribution of assets upon dissolution. Find the specific IRS-required language at [HomeschoolCPA.com/Samples](https://www.HomeschoolCPA.com/Samples).
5. Obtain a Federal Employer Identification Number (EIN) in the name of your new nonprofit corporation by submitting IRS Form SS-4. Visit [www.IRS.gov](https://www.IRS.gov) and search for "EIN."
6. The treasurer may now open a checking account in the name of the nonprofit. Transfer any funds that the former owner decides to donate.
7. Begin running your programs as a newly formed nonprofit organization. The board should hire employees, such as the director and teachers.
8. Close down the for-profit business. This may be fairly simple if you did not form as an LLC. Closing an LLC may be more involved, and the steps vary by state, so seek professional advice from a CPA or small business attorney.

After you establish your organization with a board, bylaws, and nonprofit corporation status with your state, it's time to apply for tax exempt status with the IRS.

### Apply for Tax Exempt Status

1. Have your Board of Directors vote to approve filing for 501(c)(3) tax exempt status. Approve the expenditure of funds to pay the IRS fee of \$600 and hire professional help.
2. Prepare IRS Form 1023. This is a complex form and it is advisable to hire an experienced professional. You can hire me to review your self-prepared Form 1023. I also have a template of the Form 1023 80% completed available for sale at [HomeschoolCPA.com/services/501c3-tax-exempt-status/](https://www.HomeschoolCPA.com/services/501c3-tax-exempt-status/).

### After You Receive Tax Exempt Status: State Filings

1. Receive the IRS determination letter and *celebrate!* Make copies of the letter and keep it in several safe places.
2. Read IRS Publication 4221 Compliance Guide for 501(c)(3) Charities available at [IRS.gov/pub/irs-pdf/p4221pc.pdf](https://www.IRS.gov/pub/irs-pdf/p4221pc.pdf). Discuss your record-keeping and reporting requirements with your Board of Directors.
3. Register as a charity within your state if you are required to do so. For information on what your state requires, watch the webinar IRS and State Filings available at [HomeschoolCPA.com/Filings](https://www.HomeschoolCPA.com/Filings).
4. File your annual Form 990-N, 990-EZ, or 990 every year with the IRS. Your state may have annual reports to file as well.

Forming a nonprofit organization can be a confusing and complicated process because it involves running your homeschool program in a different way with a board of directors.

Additionally, forming a nonprofit requires filing government paperwork with your state and the IRS, paying fees, hiring professionals, and maintaining tax exempt status with annual reports to the IRS and your state. The rewards of nonprofit and tax exempt status may be worth it, especially for larger homeschool programs.

## Questions and Answers

Q: If I convert my business to a nonprofit, what is my role? Can I be on the board? Can I be paid as the director?

A: That is an excellent question that all nonprofit founders face. Do I want to be involved in governance (being on the board with a vote) or be involved in the day-to-day operations as paid staff? It is not advisable to be both, and some states forbid board members to work as paid staff because it creates a conflict of interest. Some groups solve this dilemma by allowing the paid director to attend board meetings to deliver her report, but she is not allowed to vote.

Ultimately, it is up to you which role you feel best suited to your skills and talents: board governance or daily operations. My webinar “Creating a Nonprofit for Your Homeschool Community” addresses this issue and has additional information on board structures. Visit [HomeschoolCPA.com/CreateNP](http://HomeschoolCPA.com/CreateNP) for more information.

Q: I run a theater group as my LLC. I charge student fees and consider that my salary. I report all this income on my taxes. On the evening of the performance, donations are accepted in lieu of ticket sales. The donation goes to the church hosting the performance and any other costs of production (costumes, props, etc.). Lots of parents volunteer as well. Would I be better off as a nonprofit?

A: You seem to be mixing many aspects of a nonprofit with your for-profit business. Specifically, you use space in a church, accept donations of money, and you use volunteer labor. Those are acceptable in a nonprofit organization but are not permissible in a for-profit business. For legal and ethical clarity you need to operate as one or the other and not mix the two types of entities any longer. Your business should stop accepting donations and using volunteer labor and should start charging for tickets.

If you converted your business to a nonprofit organization, you could then accept donations and use volunteers. That would involve the steps outlined in this chapter and using Form 1023 to apply for 501(c)(3) status from the IRS.

Q: My church host wants my homeschool tutoring business to be a nonprofit. Why?

A: The church is probably concerned about its property tax exemption. Or they may have a policy against for-profit use of their facilities on a moral and spiritual ground, preferring to keep the “money changers” out of the house of worship. See Chapter 9 “Church Use by Businesses” for more on this.

Q: I'm interested in knowing in general terms what would be required to make our CC community a nonprofit.

A: You have a lot of issues to consider in converting your CC Community into a nonprofit organization. In the most general terms, what is needed to convert a CC Community from a business to a nonprofit is:

- A board of at least three unrelated, unpaid members. That means giving control and management authority to this board.
- Create bylaws.
- Nonprofit incorporation in your state (filing Nonprofit Articles of Incorporation).

Also highly recommended and commonplace:

- Apply for 501(c)(3) tax exempt application using Form 1023.
- Hire the Director and tutors as employees reporting to the board. This means hiring a payroll service and additional expenses for payroll taxes and fees (Social Security and Medicare, as well as Workers Compensation and Unemployment policies).

## About the Author



Carol L. Topp, CPA, is an accountant and a retired homeschooling mother. She earned her Bachelor of Science degree from Purdue University and worked as a Cost Analyst for the US Navy for ten years. In 2000, Carol passed the Certified Public Accountant (CPA) examination. Carol began homeschooling her two daughters when they started first grade. They are now homeschool graduates (and college graduates!). She was very active in her local homeschool community teaching classes and serving as her co-op's treasurer.

As an accountant, Carol has served on several nonprofit boards, including American Heritage Girls' national board. She has consulted with leaders from over 500 homeschool organizations and helped more than 100 organizations obtain 501(c)(3) tax-exempt status. In 2006, Carol launched her website [www.HomeschoolCPA.com](http://www.HomeschoolCPA.com) to help homeschool organizations lead successful groups. It has been voted a Top Accounting Blog five times, including 2019.

She is the author of *Homeschool Co-ops: How to Start Them, Run Them and Not Burn Out*, *The IRS and Your Homeschool Organization*, *Money Management in a Homeschool Organization: A Guide for Treasurers*, and *Paying Workers in a Homeschool Organization*.

Carol's publications include numerous articles, podcasts, and webinars about operating a homeschool nonprofit organization. Her articles have appeared in *The Old Schoolhouse*, *Home Education*, and *Home School Enrichment* magazines. In addition, Carol has enjoyed conducting workshops for homeschool leaders at conventions across the country.

Carol lives with her husband in Cincinnati, Ohio, where she enjoys reading, painting, traveling, and helping homeschool leaders.

Carol can be contacted through her website [www.HomeschoolCPA.com](http://www.HomeschoolCPA.com).

If you found this ebook helpful you will enjoy Carol Topp's webinar "Tax Prep for Homeschool Business Owners." It explains how to prepare a tax return for a homeschool business owner. The cost to view the 90-minute webinar is \$10. Visit [HomeschoolCPA.com/HSBIZTAXES](https://HomeschoolCPA.com/HSBIZTAXES).



If you found *Taxes for Homeschool Business Owners* helpful, visit [HomeschoolCPA.com](https://HomeschoolCPA.com) for other books by Carol Topp, CPA including:

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