



**Internal Revenue Service**

**Small Business and Self-Employed  
Taxpayer Education and Communication**



# **Tax Issues for Small Construction Companies**



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# Tax Issues for Small Construction Companies

- Accounting Methods
- Employee vs. Independent Contractor
- Office in the Home
- Automobile Expenses



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## Accounting Method

- A set of rules used to determine when and how income and expenses are reported.

	<b>Cash Method</b>	<b>Accrual Method</b>
<b>Income</b>	Include all monies actually or constructively received	Include amounts when the product or service is provided
<b>Expenses</b>	Deduct when actually paid	Deduct when the expense is incurred



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## Completed Contract Method

Report all income from the contract

AND

Deduct all related job costs in the year the  
project is completed and accepted by the  
customer





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## Employee vs. Independent Contractor

### Consider Three Common-law Rules

1. Behavioral control
2. Financial control
3. Type of relationship of the parties



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# Behavioral Control





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## Types of Instructions

- When and where to do the work?
- What work must be performed by a specified individual?
- What workers to hire or to assist with the work?
- Where to purchase supplies and services?
- What tools or equipment to use?
- What order or sequence to follow when performing the work?





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## Instructions (cont'd)

The key fact to consider is whether the business retains the **RIGHT** to control the worker regardless of whether the business actually exercises that right.





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## Training

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





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## Financial Control



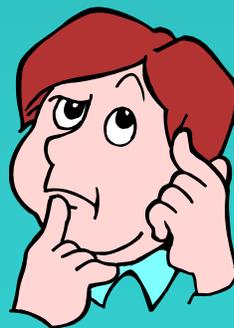


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## Financial Control Factors

- Is there a significant investment by the worker?
- Does the worker incur un-reimbursed expenses?
- Does the worker have the opportunity to make a profit or loss?
- Are the worker's services available to the market?
- What method of payment does the worker receive?





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## Type of Relationship





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# Relationship of the Parties

- Is there a written contract describing the relationship intended?
- Does the business provide the worker with employee-type benefits?
- What is the permanency of the relationship?
- To what extent are the worker's services an integral part of the business?



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## What are My Responsibilities as an Employer?

1. Have worker complete Form W-4.
2. Withhold Income tax from wages paid to employees.
3. Withhold Social Security & Medicare tax from wages to employee.
4. Pay employer's portion of Social Security & Medicare tax.
5. Deposit Income tax, Social Security, and Medicare tax at authorized bank or using EFTPS.
  - Report these taxes on Form 941.
6. Pay Federal Unemployment tax and file Form 940.



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# IRS e-file for Business and EFTPS



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## Reporting Payments To Employees

- Issue Form W-2 to Employees by January 31 of following year
- File Form W-2 and W-3 to Social Security Administration by February 28 of following year





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## Independent Contractor

- Have independent contractor complete Form W-9 before paying
- Issue Form 1099 to Independent Contractors by January 31 of following year
- File Form 1099 with IRS by February 28 of following year, attached to Form 1096





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## Automobile Expense

- Two methods are available:
- Standard Mileage Rate
- Actual Operating Cost of Business Use





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## Standard Mileage Computation

40.5 cents per mile for 2005

**PLUS**

Parking, tolls, & interest related to business

**BUT NOT**

Operating Expenses





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## Restrictions on the Standard Mileage Rate Method

- When car is used for hire (taxi)
- When operating five or more vehicles simultaneously
- When depreciation or Section 179 was taken in a prior year
- Claimed actual costs on a leased car after 1997:
  - Can't go from actual to standard
  - Leased vehicles can be on standard mileage rate, but election is irrevocable





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# Actual Cost Method- Record Keeping

Total Mileage For The Vehicle  
AND  
Total Business Miles  
PLUS  
All Receipts for Operating Costs  
AND  
Invoice For Purchase of Vehicle  
or  
Lease Agreement





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## What is Included in Operating Cost?

- Depreciation
- Gas & Oil
- Insurance
- Parking and Tolls
- Maintenance
- Repairs
- Taxes
- Licenses
- Garage Rent
- Registration Fees
- Lease Payments
- Tires
- Must keep records to substantiate each expense and % of business use.



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## Automobile Expenses

### Actual Expenses

- Multiply the business usage percentage against the total of depreciation, garage rent, gas, insurance, lease payments, licenses, oil, registration fees, repairs, and tires.





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## Actual Cost Example

EXPENSE	CAR A	CAR B
Operating Cost	\$1,500	\$1,500
Lease Payments	-0-	3,587
<b>Total Operating Costs</b>	<b>1,500</b>	<b>5,087</b>
Times Business %	.70	.70
Deduct on Line 10 - Sch C	\$1,050	\$ 3,561
Depreciation <i>(\$3,060 times 70%)</i> <i>Maximum Limit X Business %</i>	2 142	
<b>Total Deduction</b>	<b>\$3,192</b>	<b>\$ 3,561</b>



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## Office in the Home IRC Section 280A





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## Must Meet All

- **Exclusive Use**

Specific area of your home only for your trade or business.

- **Regular Use**

Use the area on a continuing basis.

- **Trade or Business Use**

Used in connection with a trade or business.





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## Must Meet One

- Principal place of business.
- A separate structure used in connection with your trade.
- Meet and deal with clients or customers in the normal course of your trade.





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# Determine Business Percentage

- Divide the area used for business by the total area of the house.

**OR**

- Divide the number of rooms used for business by the total number of rooms in the house. Rooms have to be approximately equivalent in size.





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## Other Considerations

- **Partial Year Usage:**  
Only consider that portion of the year you actually start using your home for business.
- **Deduction Limit:**  
Your business use of home expenses are limited to the tentative profit (net income before taking business use of home expenses).





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## Where are Office in the Home Expenses Deducted?

- Form 8829 - if self employed
- Schedule A - if employee
- Schedule E - if partner





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## Conclusion

- Accounting Methods
- Employee vs. Independent Contractor
- Automobile and Truck Expenses
- Office in the Home