



Tax Reduction Letter

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Rev. Rul. 81-90

ISSUE

Did the taxpayers described below properly report income and losses in preparing an individual income tax return?

FACTS

Taxpayer A is a self-employed professional. Taxpayer B, A's spouse, is also a self-employed professional. A and B file a joint federal income tax return. In 1980, A purchased a tax shelter package that included a master recording disk and a contract with Y to manufacture and market records on behalf of A. While A was the sole owner of the master recording disk, A was not involved personally in the day to day manufacturing and marketing operation. In January 1981, A received a statement from the tax shelter showing the income and deductions attributable to its operations during the preceding taxable year.

In 1980 A had receipts of 125x dollars and deductions of 25x dollars from A's professional practice and B had receipts of 100x dollars and deductions of 17x dollars from B's professional practice. In the same year A had income of 2x dollars and deductions of 12x dollars connected with the recording operation.

The instructions for Schedule C provide that a separate Schedule C must be used for each separate business. However, A and B reported the income and deductions of all three of these activities on one Schedule C in preparing their income tax return.

An audit was conducted and 20x dollars of deductions attributable to the tax shelter investment and B's professional practice were disallowed, resulting in an underpayment of tax. No other adjustments were made to the return.

LAW AND ANALYSIS

Section 6011(a) of the Internal Revenue Code provides that, when required <Page 573> by regulations prescribed by the Secretary, any person liable for any tax imposed by this title shall make a return according to the forms and regulations prescribed by the Secretary. Every person required to make a return shall include therein the information required by the forms and regulations.

Section 1.6011-1(b) of the Income Tax Regulations provides that each taxpayer should carefully prepare the taxpayer's return and set forth fully and clearly the information required to be included therein. Section 1.6011-1(b) further provides that returns which have not been so prepared will not be accepted as meeting the requirements of the Code.

Section 1.6012-1(a)(6) of the regulations prescribes Form 1040, U.S. Individual Income Tax Return, for general use by individuals in making their income tax returns.

Schedule C (Form 1040), Profit or (Loss) From Business or Profession, is to be attached to Form 1040 by the taxpayer. The instructions for Schedule C (1980 edition) state:

If you operated a business or practiced a profession, complete Schedule C. If you had more than one business, or if you and your spouse had separate businesses, please complete a Schedule C for each business.

Section 6653(a) of the Code provides that if any part of any underpayment is due to the taxpayer's negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to 5 percent of the underpayment.

HOLDING

Each of the three activities, for income tax reporting purposes, requires the filing of a separate Schedule C. The failure to file three separate Schedule C's is evidence to be weighed in determining whether A and B believed they had sufficient basis for their position, and, therefore, under such circumstances, whether the understatement could be due to negligence or intentional disregard of rules and regulations as to the items giving rise to the deficiency.

For examples of penalties which may apply to a preparer of the return, see sections 6694(a) and (b) of the Code. See also the penalty provided in section 6653(b) for application in appropriate cases where there is evidence that the failure to report properly A's and B's income and deductions was due to fraud.