

Why Filing Schedule C-EZ May Be A Big Mistake For Your Small Business

Are you a sole proprietor who files the shorter Schedule C-EZ rather than the traditional (and longer) Schedule C? If so, please read on to find out why you may be making a big mistake. First, a quick review of the qualifications for using Schedule C-EZ. You qualify if you meet these criteria:

1. Your business expenses are less than \$5,000
2. Your business has a profit
3. You have no inventory
4. You use the cash method of bookkeeping
5. You have only one business as a sole proprietor
6. You have no employees
7. You are not taking the home office deduction
8. You're not required to file Form 4562 (the form used to report depreciation and/or the Section 179 deduction for business equipment and other 'fixed assets')

Assuming you qualify, should you take advantage of this shortcut? Will it really make your tax life that much easier?

Do you notice how much shorter the EZ form is? It has only eight lines. Schedule C has forty-eight lines. So, which form would you rather file? Obviously, the one with only eight lines. And if you are not taking a vehicle deduction (which gets reported on lines 4-8), you can actually report all your business activity on only three lines: Line 1 - Sales; Line 2 - Expenses; Line 3 - Profit (Line 1 minus Line 2).

That's got to be the easiest small business tax form I've ever seen! You just add up your income, add up your expenses, do one subtraction calculation, and presto, you are done with Schedule C-EZ. Next form, please. If you are trying to simplify your tax life, this form is for you.

But here's something to think about: Sure, there's something to be said for a 3-line business tax form. But I'm here to warn you that you might be doing yourself a disservice by switching to Schedule C-EZ.

Here are my reasons:

1. If you are filing Schedule C-EZ, that means you had no business equipment expense and no home office deduction.

Is that really true? If so, fine. But I urge you NOT file Schedule C-EZ just to avoid filing Form 4562 (the business equipment form) and/or Form 8829 (the home office form). These are two of the best tax breaks offered to the self-employed. You may be missing out on hundreds or even thousands of dollars in tax savings by omitting these two forms. Even if you have to hire a professional to do your return, the cost is usually well worth it when the tax savings outweighs the tax prep fees.

2. From a business management standpoint, are you filing Schedule C-EZ because you abhor doing any type of detailed analysis of your business' income and expense records?

The regular Schedule C forces you to perform one of the best financial exercises every business needs: expense categorization. There are about twenty different expense categories on Schedule C. Most successful businesses have at least that many expense categories - tracking your expenses at this level of detail keeps your finger on the pulse of your business.

If you think you can run a profitable business by just lumping everything together into one huge catch-all expense category, well, I think you are taking a costly and potentially business-ending shortcut.

You need to know where the money goes. Failure to categorize expenses can be a symptom of financial laziness - and could be a sign that your small business is only going to get smaller and smaller. Before you know it, you won't know how or why, but you will realize that you are out of business and will be clueless as to the cause of the failure. Detailed expense categorization is the business owner's first line of defense against business failure.

So before you jump on the Schedule C-EZ bandwagon, take a close look at your bookkeeping system and see if you need to make some changes. The long-term success of your business may depend on it. I challenge you to ask yourself this question: Is the convenience of a 3-line tax form really worth it? I think not.