Advantage Tax
and
Business Services
Tax-Saving Tips

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IRS Makes It Harder to Use the Section 530 Safe Harbor

It can cost you a bundle if you misclassify a worker as an independent contractor instead of an employee for federal employment tax purposes.

The IRS can make you pay back payroll taxes plus penalties—in some cases, these can equal 40 percent of gross payroll or more. That's the bad news.

The good news: hiring firms have a "get out of jail free" card—the Section 530 safe harbor.

If your company qualifies for Section 530 relief, the IRS can't impose assessments or penalties for worker misclassification, and you may continue to treat the class of workers involved as independent contractors for employment tax purposes. This is so even if you should have classified the workers as employees under the regular IRS common law test.

Sounds great. What's the catch? The catch is that it can be hard for a hiring firm to qualify for Section 530.

You must satisfy three requirements to qualify for Section 530 relief:

1. You must have filed all required Form 1099-NEC returns (or other required information returns) for the workers involved.

2. You must have treated all workers doing substantially similar work consistently as independent contractors.

3. You must have a reasonable basis for treating the workers as independent contractors, such as a legal case, prior IRS audit, or long-standing practice in the industry.

For the first time in 40 years, the IRS has issued a new revenue procedure updating how it should apply Section 530. Unfortunately, the new procedure can make it harder for hiring firms to qualify for Section 530 relief.

The IRS says that in making its determination of whether a hiring firm has a reasonable basis for classifying its workers as independent contractors, it may consider whether the firm treated the workers involved as employees for non-tax purposes, such as for federal or state labor law or for state unemployment insurance or workers' compensation insurance coverage.

This can be problematic for hiring firms because there are various reasons why a firm might treat a worker as an employee for non-tax purposes—reasons that have nothing to do with whether the firm reasonably believed the worker qualified as an independent contractor for IRS purposes.

The IRS's new approach makes it more important than ever for hiring firms that use independent contractors to plan ahead to ensure that they qualify for Section 530 relief. Hiring firms must document that they qualify for relief when they classify the workers as independent contractors. You can't wait until you are audited, and the IRS questions your worker classification practices, to think about Section 530.

Protect Yourself: Digitize Tax Receipts

When it comes to IRS audits, one of the most common reasons taxpayers lose deductions is the lack of proper documentation.

While your credit card or bank statements prove you spent money, they don't show what you purchased. Without supporting receipts or invoices, these records are considered "naked"—and during an audit, that's a problem.

To fully protect your deductions, especially for business-related expenses such as meals, travel, vehicle use, and gifts, you need to keep receipts that document five key facts: the date, the amount, the place, the business purpose, and the business relationship. The best way to do this is by capturing digital copies of your receipts.

Fortunately, it's now easier than ever. Using your smartphone, you can snap a photo of your receipt and store it securely using apps such as Shoeboxed, Expensify, Zoho Expense, and others. These tools often let you add notes, categorize expenses, and sync directly with accounting software like QuickBooks or FreshBooks.

Why go digital? Paper receipts fade—especially those printed on thermal paper. Digitizing them ensures they're legible and accessible when needed, whether for year-end tax preparation or an unexpected audit.

Taking a few seconds now to scan or photograph each receipt can save you time, stress, and potential lost deductions later.

Avoid Unwanted Partnership Tax Status: Elect Out

If you're involved in a real estate or investment venture with one or more other parties—perhaps co-owning property or collaborating on a business project—you might think you're simply sharing ownership.

But the IRS may see it differently. Without proper precautions, your arrangement could be classified as a partnership for federal tax purposes, triggering filing requirements and potential penalties you weren't expecting.

Why It Matters

Under IRS rules, many informal joint ventures—such as syndicates, pools, and unincorporated business arrangements—can be treated as partnerships, even without a legal partnership agreement.

This could mean:

- You would need to file Form 1065 annually.
- You would have to issue Schedule K-1s to all co-owners.
- You might lose eligibility for Section 1031 like-kind exchanges.
- You could incur potential IRS penalties of up to $255 a month per partner, limited to 12 months.

Fortunately, if your situation qualifies, you can elect out of partnership status and avoid these headaches.

How to Elect Out

The IRS allows co-owners of certain investments—such as real estate or oil and gas ventures—to opt out by filing a “blank” Form 1065 with specific details and a formal election statement. This proactive step ensures each owner can independently report income and deductions on their return, often using Schedule E or Schedule F of Form 1040.

Take Action Now

Failing to file a partnership return when required can be costly.

Greed or Goodwill? Your Motive Makes a Scam Loss Deductible

Scams are incredibly common.

According to recent Federal Trade Commission data, consumers reported losing more than $12.5 billion to fraud in 2024. They reported losing more money to investment scams—$5.7 billion—than any other category. Older people are particularly prone to being scammed.

If you’re the victim of a scam, can you deduct your losses as a theft loss? In the past, you often could because losses due to fraud and larceny were deductible theft losses subject to certain limits.

All this changed in 2017 when Congress enacted the Tax Cuts and Jobs Act (TCJA). The TCJA added a new provision to the tax code, providing that from 2017 to 2025, personal theft losses are deductible only if they are attributable to a federally declared disaster. This means almost all theft losses are not deductible at all during these years.

But all is not necessarily lost for fraud victims. Thefts involving business property and those involving transactions entered into for profit are deductible without the need for a disaster. Thefts arising from for-profit activities are deductible as a miscellaneous itemized deduction on Schedule A, not subject to the 2 percent of adjusted gross income floor.

Thus, if you’re the victim of a scam, you can get a theft loss deduction if it arose from a for-profit transaction.

The IRS chief counsel has provided helpful guidance explaining when common scams are deductible. The scams clarified involve victims transferring money from their IRA and non-IRA accounts to scammers, typically overseas.

The IRS chief counsel advised that losses due to compromised account scams, “pig butchering” investment scams, and phishing scams are deductible because the victims of these scams all have a profit motive: earning more investment returns or safeguarding IRA and non-IRA accounts established to earn a profit.

On the other hand, losses due to romance scams or fake kidnapping scams are not deductible as theft losses because the victims voluntarily transferred their money to the scammers out of mistaken love or intending to protect loved ones—which are not profit motives. Their losses were non-deductible personal theft losses.

In short, losses due to scams that rely on the victim’s greed are deductible. Losses from scams that count on the victim’s love or desire to help others are not deductible.

This seems ridiculous, but it is the natural result of the very harsh rule established by the TCJA, which states that personal theft losses are never deductible. The IRS chief counsel tries to ameliorate the harshness of this rule by taking a relatively liberal view of what constitutes a transaction entered into for profit.