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Monthly Updates

December 2020

Good News If Your PPP Loan Is for \$50,000 or Less

As you likely know by now, the Paycheck Protection Program (PPP) loan and its forgiveness process have been an ever-changing (and often confusing) ride so far.

With the new rules for PPP loans of \$50,000 or less, you escape the most difficult part of the loan forgiveness if you had to consider employees. And you may even obtain more loan forgiveness than you would have otherwise.

Before

Before the \$50,000-or-less rule, you had to either suffer a reduction in loan forgiveness or meet one of the many exceptions that allowed you to

- cut annual salaries or hourly wages by more than 25 percent, and/or
- reduce the average number of employees or average hours paid.

After

Now, with a PPP loan of \$50,000 or less, you don't have to consider the myriad rules about employees. Regardless of what you did with your employees, you qualify for full forgiveness if

- your PPP loan is for \$50,000 or less,
- you spent the PPP money on costs that are eligible for forgiveness, and
- at least 60 percent of the forgiveness is for qualified payroll costs (including defined payroll for owners).

Example. You obtain a PPP loan of \$34,000 based on your 2019 Schedule C income and pay to your part-time employee. When COVID-19 hit, you laid off your part-time worker and have not rehired him. Using SBA Form 3508S and the 24-week covered period, you qualify for 100 percent forgiveness of your \$34,000 loan because you spent \$20,833 (61 percent) on the deemed payroll to yourself and the remainder on five months' rent and utilities.

Planning note. You are not an employee of your Schedule C business. You receive no W-2 income. But the PPP rules deem your 2019 Schedule C profits as your payroll for PPP loan purposes. The rules cap the Schedule C taxpayer's loan amount and forgiveness at a maximum of \$20,833 when Schedule C income is \$100,000 or more.

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Four Things to Know When Hiring Your Spouse

If you own your own business and operate as a proprietorship or partnership (wherein your spouse is not a partner), one of the smartest tax moves you can make is hiring your spouse to work as your employee.

But the tax savings may be a mirage if you don't pay your spouse the right way. And the arrangement is subject to attack by the IRS if your spouse is not a bona fide employee.

Here are four things you should know before you hire your spouse that will maximize your savings and minimize the audit risk.

1. Pay benefits, not wages. The way to save on taxes is to pay your spouse with tax-free employee benefits, not taxable wages. Benefits such as health insurance are fully deductible by you as a business expense, but not taxable income for your spouse.

Also, if you pay a spouse only with tax-free fringe benefits, you need not pay payroll taxes, file employment tax returns, or file a W-2 for your spouse.

2. Establish a medical reimbursement arrangement. The most valuable fringe benefit you can provide your spouse-employee is reimbursement for health insurance and uninsured medical expenses. You can accomplish this through a 105-HRA plan if your spouse is your sole employee, or an Individual Coverage Health Reimbursement Account (ICHRA) if you have multiple employees.

3. Provide benefits in addition to health coverage. There are many other tax-free fringe benefits you can provide your spouse in addition to health insurance, including education related to your business, up to \$50,000 of life insurance, and de minimis fringes such as gifts.

4. Treat your spouse as a bona fide employee. For your arrangement to withstand IRS scrutiny, you must be able to prove that your spouse is your bona fide employee. You'll have no problem if:

- you are the sole owner of your business,
- your spouse does real work under your direction and control and keeps a timesheet,
- you regularly pay your spouse's medical and other reimbursable expenses from your separate business checking account, and
- your spouse's compensation is reasonable for the work performed.

New IRS Efforts to Destroy Tax Deductions for PPP Paid Expenses

From what we know, when lawmakers originally passed the PPP they thought that under its provisions,

- you did not pay taxes on the forgiveness amount, and
- you also could deduct the expenses that you paid with the PPP money.

Obstacle

In late April, the IRS issued Notice 2020-32, which asserts that PPP loan recipients may not deduct business expenses paid using the PPP monies that gave rise to forgiveness (defined payroll, rent, utilities, and interest).



Lawmakers' Take

In a letter to Secretary of the Treasury Steven Mnuchin on May 5, 2020, Senator Chuck Grassley (chairman of the Committee on Finance), Senator Ron Wyden (ranking member on the Committee on Finance), and Congressman Richard E. Neal (chairman of the Committee on Ways and Means) jointly stated that the IRS got this wrong and that the intent of the CARES Act was for the PPP to be a tax-free grant.

The Do-Nothings

The IRS was unmoved by the lawmakers' letter. The IRS position was clear: no deduction for the expenses paid with the PPP money. The IRS understood that perhaps lawmakers didn't mean that to happen, but in the eyes of the IRS, the way that the lawmakers enacted the law created the problem. To fix it, lawmakers simply need to pass a new law.

Frankly, we thought that lawmakers would pass a new law and take care of this problem. But no, that has not happened.

New Nails in the Coffin

On November 18, 2020, the IRS drove two new nails into the coffin regarding deductions for PPP monies that were forgiven and spent on payroll, rent, interest, or utilities.

- **Nail 1.** In Revenue Ruling 2020-27, the IRS ruled that you may not deduct expenses paid with the PPP loan monies if you have received or expect to receive forgiveness of those loan monies.

- **Nail 2.** In Revenue Procedure 2020-51, the IRS set forth safe-harbor procedures to follow if your PPP forgiveness is subsequently denied or if you decide not to apply for forgiveness.

With the rulings described above, the IRS has clarified its position to lawmakers: if you don't like the non-deductibility of expenses paid with PPP monies, change the law.

What to Do Now

Join with hundreds of thousands of business taxpayers and tax professionals who are urging lawmakers to fix the non-deductibility issue.

To help encourage the action you desire (whether you're for or against deductibility), get in touch with the lawmakers.

- S. 3612 is the Senate bill to make the PPP forgiveness money used to pay business expenses tax-deductible. To express your ye or nay on S. 3612, contact your senators. You can find them at this link: <https://www.senate.gov/senators/contact>.
- H.R. 6821 is the House bill to make the PPP forgiveness money used to pay business expenses tax-deductible. To express your ye or nay on H.R. 6821, contact your representative. You can find him or her at this link: <https://www.house.gov/representatives>.

Your ye or nay doesn't need to be long or formal. You can fax, email, or phone and simply say you support or oppose the bill. It's that easy—and it's effective. Do it.

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The IRS Goes Easy on Taxpayers Who Owe Back Taxes

Are you one of the over 11 million Americans who owe the IRS back taxes? The IRS temporarily suspended most collection efforts during the first wave of the coronavirus pandemic through its “People First Initiative.” This initiative expired July 15, 2020.

The IRS is now ready to go after delinquent accounts again. However, the agency recognizes that substantial numbers of taxpayers cannot pay what they owe right now. To help them, it has promulgated a new Taxpayer Relief Initiative.

The new Taxpayer Relief Initiative is relatively modest in scope, but it can be a big help if you owe the IRS.

Among other things, the new initiative gives you an extra 60 days to pay off a tax bill. You now have 180 days instead of 120 days to make a lump sum payment of all you owe.

The initiative also makes it easier to obtain, keep, and modify installment agreements with the IRS. These allow you to make monthly payments over several years.

If you owe \$50,000 to \$250,000, you may even be able to obtain an installment agreement without the IRS filing a tax lien on your property—something that has never been possible before.

The IRS is also stressing that it will help taxpayers who have already entered into installment agreements or offers in compromise with the agency and who are now having trouble making their payments.

You may also be able to get IRS penalties reduced or eliminated.

Whatever you do, don’t ignore a tax bill from the IRS. And never feel you’re helpless when confronted by the IRS collection juggernaut. You always have options, no matter how much you owe.

Tax-Smart College Savings Strategies for Parents

College is expensive. Data for the 2019–2020 academic year indicates that the average cost of tuition, fees, room, and board was \$30,500. The tax law has provisions to help you cover the costs, including Coverdell accounts, Section 529 savings plans, and Section 529 tuition plans.

Contribute to a Coverdell Education Savings Account

You can contribute up to \$2,000 per year to the child’s Coverdell Education Savings Account (CESA). If you have several children, you can set up a CESA for each of them.

Contributions are non-deductible, but earnings are allowed to accumulate free of any federal income tax. You can then take tax-free withdrawals to pay for the account beneficiary’s post-secondary tuition, fees, books, supplies, and room and board.

Maybe not for you. Your right to contribute is phased out between modified adjusted gross income (MAGI) of \$95,000 and \$110,000 if you are unmarried, or between \$190,000 and \$220,000 if you are a married joint filer.



Contribute to a Section 529 College Savings Plan

Section 529 college savings plans are state-sponsored arrangements named after the section of our beloved Internal Revenue Code that authorizes very favorable treatment under the federal income and gift tax rules.

You as the parent of a college-bound child begin by making contributions into a trust fund set up by the state plan that you choose. The money goes into an account designated for the beneficiary whom you specify (your college-bound child).

You can then make contributions via a lump-sum pay-in or via installment pay-ins stretching over several years. The plan then invests the money using the investment direction option that you select.

When your child reaches college age, you can take federal-income-tax-free withdrawals to pay eligible college expenses, including room and board under most plans. Plans will generally cover expenses at any accredited college or university in the country (not just schools within the state sponsoring the plan). Community colleges qualify as well.

In essence, a Section 529 college savings plan account is a tax-advantaged way to build up a college fund for your child.

Don't Confuse Savings Plans with Prepaid Plans

Don't mix up Section 529 college savings plans with Section 529 prepaid college tuition plans—which we will give only a brief mention here. Both types of plans are properly called “Section 529 plans” because both are authorized by that section of the Internal Revenue Code. Both receive the same favorable federal tax treatment. But that's where the resemblance ends.

The big distinction is that prepaid tuition plans lock in the cost to attend certain colleges. In other words, the rate of return on a prepaid tuition plan account is promised to match the inflation rate for costs to attend the designated school or schools—nothing more, nothing less. That's okay if that's what you really want.

No Kiddie Tax on Section 529 Plan

You don't have to worry about the kiddie tax if you set up a custodial 529 plan in the child's name. The 529 plan is an investment plan where the monies remain in the plan. You make contributions with after-tax dollars.

When the child takes the money out of the plan for college, he or she does so tax-free when the funds are used to pay for qualified higher education expenses.

Proposition 19: Impact on Property Taxes and Transfers to Children PLANNING DEADLINE: New Law Goes into effect February 16, 2021

On November 3, 2020, California voters approved Proposition 19, which will severely impact property taxes on real property transferred to children after February 16, 2021.

In California, property taxes are levied annually based on the property's “assessed value” (typically determined at the time of purchase) and can only increase 2% per year unless a “change in ownership” occurs. Thus, if you have owned your property for decades, you are likely paying lower property taxes than your neighbors who have more recently purchased their property.



Property taxes are reassessed (at the then fair market value) when there is a “change in ownership” unless an exclusion applies. Effective February 16, 2021, Prop 19 will impose severe limitations on the (currently generous) Parent-Child Exclusion from property tax reassessment. Property owners wishing to transfer real property to their children (or, in limited circumstances, to their grandchildren) should read this notice carefully and consider contacting us for further guidance and a referral to an attorney to assist in any transaction.

SUMMARY OF CHANGES TO EXCLUSION RULES

Current Rules

Parents can transfer their principal residence’s current assessed value to their children, regardless of the residence’s value and regardless of whether the children thereafter occupy the property.

Parents can transfer up to \$1 million of assessed value of other real property (vacation, rental, etc.) to their children.

Rules After Prop 19

Parents can transfer their principal residence’s current assessed value only if a child will also occupy the property as their principal residence, and this is limited to \$1 million of exclusion of fair market value above current assessed value.

Any transfer of other real property (vacation, rental, etc.) will result in a full reassessment for property tax purposes.

WHAT DOES THIS MEAN FOR YOU AND YOUR FAMILY?

Transferring real property to your children before February 16, 2021 may lock in the assessed value and could save your children significant amounts of money on future property taxes. However, since there

are additional tax and control implications to consider before you complete any transaction.

WHO SHOULD ACT IMMEDIATELY?

- 1) Owners of California real estate with a low assessed value whose **children** wish to retain the property after inheritance/transfer.
- 2) People currently administering a **Trust/Estate** (Bypass, Credit Trusts) where the decedent’s children wish to retain the **real property**. If possible, transfers should be completed prior to February 16, 2021 or you may cost the beneficiaries thousands of dollars in future property taxes.
- 3) People with a Qualified Personal Residence Trust (QPRT) where the fixed term ends on or after February 16, 2021.

OUR IMMEDIATE GOAL

Various planning strategies are being discussed among California estate planning professionals. However, any strategy is hypothetical until the governing regulations are issued by the Board of Equalization (BOE), which we anticipate occurring in January. Even after regulations are provided, the BOE regularly issues additional guidance to County Assessors based (in part) on subsequent court decisions. Since these rules are new, we cannot guarantee whether an effective strategy exists without further guidance from the governing agencies and courts. Thus, the goal is to determine if a transfer of your real property prior to February 16, 2021 makes sense.

SELF-ASSESSMENT AND YOUR NEXT STEPS

For each parcel of California real estate you may wish to transfer to your children, please complete this Self-Assessment to determine whether you should immediately schedule a Prop 19 Consultation:

1) Do you own any California property that was **ORIGINALLY** purchased by you individually, jointly, by a trust, or was inherited? (i.e., **NOT** originally purchased by an LLC, corporation, or similar legal entity.) (For most clients owning California property the answer to this question will be Yes.)

- NO: No need for a Prop 19 Consultation
- YES: Proceed to question 2

2) Are you willing and able to give up control of, access to, and equity in any of your real property during your lifetime?

- NO: No need for a Prop 19 Consultation
- YES: Proceed to question 3

3) Do your children wish to retain any of your real property following your death or lifetime transfer of the property?

- NO: No need for a Prop 19 Consultation
- YES: Proceed to question 4

4) Is there a significant difference between the current fair market value and the “assessed value” of any of your real property? (The term “significant” is subjective. For example, a difference of \$100,000 may result in a property tax increase of approximately \$1,100 per year (approximately \$11,000 over ten years). A difference of \$500,000 may result in a property tax increase of approximately \$55,000 over ten years.)

- NO: No need for a Prop 19 Consultation
- YES: You May Benefit From Prop 19 Planning - Proceed to “**Your Next Steps**”

Your Next Steps: Please contact us to schedule a Prop 19 Consultation. We do not have long before this law goes into effect. If you do not contact us immediately, we may not be able to assist you prior to the deadline. We estimate the consultation to take about 1 hour of time.

Prior to your Prop 19 Consultation, please provide a copy of your existing Trust (unless we already have it). In addition, for each parcel of California real estate please provide:

1. A copy of the most recent property tax bill;
2. The value of the mortgage, if any, on the property;
3. The current fair market value of the property (an estimate is acceptable); and
4. The current income tax basis of the property (if you are unsure, consult your tax advisor).

Regardless of whether Prop 19 affects you, a periodic review of your estate plan is recommended. We are happy to schedule a periodic review consultation for you after February 16, 2021. Should you have any questions or concerns, please do not hesitate to contact our office.



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