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CERTIFIED PUBLIC ACCOUNTANTS, INC.

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Monthly Updates

March 2022

APRIL 18th – Tax Day 2022

We are quickly approaching the individual tax deadline of April 18th. If for some reason you can't file your federal tax return on time, it's relatively easy to get an automatic six-month extension to October 17, 2022. Please let us know if you would like for us to file an extension. If we do not hear from you by April 1st we will automatically file an extension for you.

Keep in mind, however, that an extension to file doesn't extend the time to pay your tax. If you don't pay up by the original due date, you'll owe interest and penalties on the unpaid tax.

Also, 2021 Traditional IRA, Roth IRA and Health Savings account contributions can be made up until April 18, 2022. So if you plan on making a contribution for 2021 make sure you make it before the deadline.

How to (correctly) Fix a Forgotten, Missed, or Miscalculated Required Minimum Distribution (RMD)

Tax-deferred accounts have long been a boon to savers, allowing them to earn additional growth on top of the growth without Uncle Sam taking a share. But tax-deferred doesn't mean tax-free, and sooner or later, Uncle Sam will eventually take his share, since each and every retirement account is subject to Required Minimum Distribution (RMD) rules at some point (even Roth accounts, after the death of the original owner!).

Unfortunately, though, the RMD rules can be maddeningly complicated, making it easy for taxpayers to make a mistake by taking a smaller-than-required distribution, taking a distribution from the wrong account (or even the wrong type of account), or (worse yet) missing a distribution altogether. In fact, mistakes in satisfying RMD obligations are so widespread among retirees that in just 2020 and 2019, over a quarter-million individuals failed to take an RMD from their IRAs alone.

The problem, of course, is that, not only does a taxpayer still have to catch up on any of their distributions that were missed (which could end out having adverse tax consequences if a large enough amount has to be taken), but the IRS will impose an additional penalty of a whopping 50% of the amount that was supposed to have been distributed in the first place even if the mistake was purely unintentional.

The good news, though, is that the IRS isn't entirely without compassion and understanding and has the option to decide to waive that punitive penalty for failing to take an RMD. However, it's important to note that the onus is on the taxpayer to reach out to the IRS, explain that their mistake was the result of a "reasonable error," and show how they are taking "reasonable steps" to remedy the shortfall.

1. The first step towards requesting a waiver for a failed RMD is to take the missed distribution(s) as soon as possible, preferably separately and without any additional taxes withheld (so that the amount deposited into a receiving account exactly matches the shortfall).
2. From there, the taxpayer must (correctly) file the appropriate Form 5329 for each of the years that a distribution mistake was made. The caveat is that there is one line in particular - line 54 - which can easily throw a wrench in the works, as the proper way to request the penalty waiver is to not fill out the line the way it is explained on Form 5329 itself, and instead to mark a request for waiver next to that line instead.
3. And, in addition to that, the taxpayer must also attach a letter explaining the reasonableness of both their error and their corrective measure to the IRS.

In the end, the key point is that, while RMD mistakes are common among owners (and beneficiaries) of tax-preference retirement accounts, it's actually quite likely that the IRS will waive the 50% penalty but only if the appropriate steps are taken in a timely manner to rectify the error.

IRAs for Kids

Working at a tender age is an American tradition. What isn't so traditional is the notion of kids contributing to their own IRA, especially a Roth IRA. But it *should* be a tradition, because it's a really good idea. Here's what you need to know about IRAs for kids. Let's start with the Roth IRA option.

Roth IRA Contribution Basics

The only federal-income-tax-law requirement for a child to make an annual Roth IRA contribution is to have enough earned income during the year to cover the contribution. Age is completely irrelevant.

So if a child earns some cash from a summer job or part-time work after school, he or she is entitled to make a Roth contribution for that year.

For both the 2021 and 2022 tax years, your working child can contribute the lesser of

- his or her earned income for the year, or
- $6,000.

While the same $6,000 contribution limit applies equally to Roth IRAs and traditional IRAs, the Roth option is usually better for kids.

Key point. A contribution for your child's 2021 tax year can be made as late as April 15, 2022. So, there's still time for that.

Modest Contributions to Child's Roth IRA Can Amount to Big Bucks by Retirement Age

By making Roth contributions for a few years during the teenage years, your kid can potentially accumulate quite a bit of money by retirement age.

But realistically, most kids won't be willing to contribute the $6,000 annual maximum even when they have enough earnings to do so.

Say the child contributes $2,500 at the end of each year for four years. Assuming a 5 percent annual rate of return, the Roth account would be worth about $82,000 in 45 years. Assuming a more optimistic 8 percent return, the account value jumps to a whopping $259,000. Wow!

You get the idea. With relatively modest annual contributions for just a few years, Roth IRAs can be worth eye-popping amounts by the time your "kid" approaches retirement age.

Vacation Home Rental—What's Best for You: Schedule C or E?

Do you have a beach or mountain home that you rent out?

If the average period of rental is less **than 30 days**, you likely have a choice—either

- claim the income and expenses on Schedule C, or
- claim the income and expenses on Schedule E.

When Is Schedule C a Good Choice?

If you show a tax loss on your rental property, Schedule C is a great choice because it allows you to deduct your rental losses against all other income (assuming you materially participate in the rental property).

If you show **taxable income** on the rental property, Schedule C is **not good** because it causes you to pay self-employment taxes.

When Is Schedule E a Good Choice?

If you show taxable income on the transient rental, Schedule E is best because you don't pay any self-employment taxes on Schedule E income.

If you show a loss on your transient rental and you materially participate, you can deduct your losses against all other income, but those Schedule E losses do not reduce self-employment income.

IRS in Summary Mode

In recent advice, the IRS stated that rentals of living quarters are not subject to self-employment tax **when no services** are rendered for the occupants.

But if services are rendered for the occupants, and the services rendered

1. are not clearly required to maintain the space in a condition for occupancy, and
2. are of such a substantial nature that the compensation for these services can be said to constitute a material portion of the rent,

then the net rental income received is subject to the self-employment tax.

Entertainment Facility: Perk for You, Your Net Worth, and Your Employees

Imagine this: your Schedule C business buys a home at the beach, uses it solely as an entertainment facility for business, pays off the mortgage, and deducts all the expenses.

Now say, 10 years later, without any tax consequence to you, you start using the beach home as your own.

Is this possible? Yes. Are there some rules on this? Yes. Are the rules difficult? No.

Okay, so could you achieve the same result if you operate your business as a corporation? Yes, but the corporation needs to rent the property from you or reimburse you for the facility costs, including mortgage interest and depreciation—because you want the title to always be in your name, not the corporation's name.

The beach home, ski cabin, or other entertainment facility must be **primarily for the benefit of employees** other than those who are officers, shareholders, or other owners of a 10 percent or greater interest in the business, or other highly compensated employees. In this situation, you create

- 100 percent entertainment facility tax deductions for the employer (you or, if incorporated, your corporation), and
- tax-free use by the employees.

The employee facility deduction is straightforward. It has three splendid benefits for the small-business owner:

1. You deduct the facility as a business asset.
2. Your employees get to use the facility tax-free.
3. You own the property and can use it personally without tax consequences once **you no longer need it for business use**. (Note that when you sell, you will have a gain or loss on the sale and some possible recapture of depreciation.)

CALIFORNIA GOVERNOR SIGNS MAJOR BILL TO CHANGE THE AB 150 ENTITY WITHHOLDING TAX

California just enacted Senate Bill 113 (SB 113), which made California's new passthrough entity elective tax much more attractive for certain owners of S corporations, partnerships, and LLCs taxed as a partnership or S corporation.

Many of the limitations and drawbacks to paying this tax were just recently removed by SB 113. Now, this passthrough entity elective tax can dramatically reduce the tax liability of many more taxpayers.

This is because if the entity elects to pay the tax at the entity level it reduces the amount of federal K-1 income passed through to you. The entity is not subject to the $10,000 state and local tax (SALT) limitation enacted by the Tax Cuts and Jobs Act, so it can claim a significantly higher tax deduction than you can on your individual return. Plus, you get to claim up to a 100% credit on your California return for your share of the tax paid by the entity.

Prior to SB 113, there were significant limitations that made this option unattractive for many taxpayers.

However, this new law greatly improved this elective tax option by:

- Eliminating tentative minimum tax limitations;
- Including guaranteed payments paid to partners/LLC members in the tax base; and
- Expanding which entities can make the election and the types of owners for whom the tax may be paid.

If you are a shareholder, partner or member of an S corporation, partnership, or LLC taxed as a partnership or S corporation, you might be able to significantly reduce your tax liability as a result of this greatly expanded SALT workaround.

This may be quite beneficial, but there are a lot of factors to consider in evaluating whether it makes sense for a passthrough entity to make the election, and whether you should consent to have the entity pay tax on your share of the entity's income.

For 2021, the Elective Tax is due on or before March 15, 2022, but the business can elect to participate as long as the election is made on a timely (extended) tax return. However, if the payment is made after March 15, 2022 California will charge interest on any late payment.

For taxable years 2022 through 2025, the Elective Tax is due in two installments:

- The first installment is due by June 15th of the current year, and is the greater of $1,000 or 50% of the Elective Tax paid in the prior year; and
- The second installment for the remaining amount is due on or before March 15 of the subsequent year.