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## Monthly Updates

November 2020

### 2020 Last-Minute Year-End General Business Income Tax Deductions

Your goal should be to get the IRS to owe *you* money. Of course, the IRS is not likely to cut you a check for this money (although in the right circumstances, that will happen), but you'll realize the cash when you pay less in taxes.

Here are seven powerful business tax-deduction strategies that you can easily understand and implement before the end of 2020.

#### 1. Prepay Expenses Using the IRS Safe Harbor

You just have to thank the IRS for its tax-deduction safe harbors. IRS regulations contain a safe-harbor rule that allows cash-basis taxpayers to prepay and deduct qualifying expenses up to 12 months in advance without challenge, adjustment, or change by the IRS.

Under this safe harbor, your 2020 prepayments cannot go into 2022. This makes sense, because you can prepay only 12 months of qualifying expenses under the safe-harbor rule.

For a cash-basis taxpayer, qualifying expenses include lease payments on business vehicles, rent payments on offices and machinery, and business and malpractice insurance premiums.

**Example.** You pay \$3,000 a month in rent and would like a \$36,000 deduction this year. So on Thursday, December 31, 2020, you mail a rent check for \$36,000 to cover all of your 2021 rent. Your landlord does not receive the payment in the mail until Tuesday, January 5, 2021. Here are the results:

- You deduct \$36,000 in 2020 (the year you paid the money).
- The landlord reports taxable income of \$36,000 in 2021 (the year he received the money).

You get what you want—the deduction this year. The landlord gets what he wants—next year's entire rent in advance, eliminating any collection problems while keeping the rent taxable in the year he expects it to be taxable.

Don't surprise your landlord: if he had received the \$36,000 of rent paid in advance in 2020, he would have had to pay taxes on the rent money in tax year 2020.

#### 2. Stop Billing Customers, Clients, and Patients

Here is one rock-solid, time-tested, easy strategy to reduce your taxable income for this year: stop billing your customers, clients, and patients until after December 31, 2020. (We assume here that you or your corporation is on a cash basis and operates on the calendar year.)

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Customers, clients, patients, and insurance companies generally don't pay until billed. Not billing customers and patients is a time-tested tax-planning strategy that business owners have used successfully for years.

**Example.** Jim, a dentist, usually bills his patients and the insurance companies at the end of each week; however, in December, he sends no bills. Instead, he gathers up those bills and mails them the first week of January. Presto! He just postponed paying taxes on his December 2020 income by moving that income to 2021.

### 3. Buy Office Equipment

With bonus depreciation now at 100 percent along with increased limits for Section 179 expensing, buy your equipment or machinery and place it in service before December 31, and get a deduction for 100 percent of the cost in 2020.

Qualifying bonus depreciation and Section 179 purchases include new and used personal property such as machinery, equipment, computers, desks, chairs, and other furniture (and certain qualifying vehicles).

### 4. Use Your Credit Cards

If you are a single-member LLC or sole proprietor filing Schedule C for your business, the day you charge a purchase to your business or personal credit card is the day you deduct the expense. Therefore, as a Schedule C taxpayer, you should consider using your credit card for last-minute purchases of office supplies and other business necessities.

If you operate your business as a corporation, and if the corporation has a credit card in the corporate

name, the same rule applies: the date of charge is the date of deduction for the corporation.

But if you operate your business as a corporation and you are the personal owner of the credit card, the corporation must reimburse you if you want the corporation to realize the tax deduction, and that happens on the date of reimbursement. Thus, submit your expense report and have your corporation make its reimbursements to you before midnight on December 31.

### 5. Don't Assume You Are Taking Too Many Deductions

If your business deductions exceed your business income, you have a tax loss for the year. With a few modifications to the loss, tax law calls this a "net operating loss," or NOL.

If you are just starting your business, you could very possibly have an NOL. You could have a loss year even with an ongoing, successful business.

You used to be able to carry back your NOL two years and get immediate tax refunds from prior years; however, the Tax Cuts and Jobs Act (TCJA) eliminated this provision. Now, you can only carry your NOL forward, and it can only offset up to 80 percent of your taxable income in any one future year.

What does all this mean? You should never stop documenting your deductions, and you should always claim all your rightful deductions. We have spoken with far too many business owners, especially new owners, who don't claim all their deductions when those deductions would produce a tax loss.



## 6. Thank COVID-19

Let's be real: there's little to be grateful for with COVID-19, but one of the several exceptions is the potential opportunity to turn NOLs into cash for your business.

Two NOL opportunities come from the Coronavirus Aid, Relief, and Economic Security (CARES) Act:

1. The CARES Act allows NOLs arising in tax years beginning in 2018, 2019, and 2020 to be carried back five years for refunds against prior taxes.
2. The CARES Act allows application of 100 percent of the NOL to the carryback years.

Before the CARES Act, you could *not* carry back your 2018, 2019, or 2020 losses, and your NOL could offset only up to 80 percent of taxable income before your Section 199A deduction.

## 7. Deal with Your Qualified Improvement Property

In the CARES Act, Congress finally fixed the qualified improvement property (QIP) error that it made in the TCJA.

QIP is any improvement made by the taxpayer to the interior portion of a building that is non-residential real property (think office buildings, retail stores, and shopping centers) if you place the improvement in service after the date you place the building in service.

If you have such property on an already filed 2018 or 2019 return, it's on that return as 39-year property. You now have to change it to 15-year property, eligible for both bonus depreciation and Section 179 expensing.

## 2020 Last-Minute Section 199A Tax Reduction Strategies

Remember to consider your Section 199A deduction in your year-end tax planning.

If you don't, you could end up with a big fat \$0 for your deduction amount. We'll review three year-end moves that (a) reduce your income taxes and (b) boost your Section 199A deduction at the same time.

### First Things First

If your taxable income is above \$163,300 (or \$326,600 on a joint return), then your type of business, wages paid, and property can reduce and/or eliminate your Section 199A tax deduction.

If your deduction amount is less than 20 percent of your qualified business income (QBI), then consider using one or more of the strategies described below to increase your Section 199A deduction.

### Strategy 1: Harvest Capital Losses

Capital gains add to your taxable income, which is the income that

- determines your eligibility for the Section 199A tax deduction,
- sets the upper limit (ceiling) on the amount of your Section 199A tax deduction, and
- establishes when you need wages and/or property to obtain your maximum deductions.

If the capital gains are hurting your Section 199A deduction, you have time before the end of the year to harvest capital losses to offset those harmful gains.



## Strategy 2: Make Charitable Contributions

Since the Section 199A deduction uses taxable income for its thresholds, you can use itemized deductions to reduce and/or eliminate threshold problems and increase your Section 199A deduction.

Charitable contribution deductions are the easiest way to increase your itemized deductions before the end of the year (assuming you already itemize).

## Strategy 3: Buy Business Assets

Thanks to 100 percent bonus depreciation and Section 179 expensing, you can write off the entire cost of most assets you buy and place in service before December 31, 2020.

This can help your Section 199A deduction in two ways:

1. The big asset purchase and write-off can reduce your taxable income and increase your Section 199A deduction when it can get your taxable income under the threshold.
2. The big asset purchase and write-off can contribute to an increased Section 199A deduction if your Section 199A deduction currently uses the calculation that includes the 2.5 percent of unadjusted basis in your business's qualified property. In this scenario, your asset purchases increase your qualified property, which in turn increases the deduction you already depend on.

## 2020 Last-Minute Year-End Tax Strategies for Your Stock Portfolio

When you take advantage of the tax code's offset game, your stock market portfolio can represent a little gold mine of opportunities to reduce your 2020 income taxes.

The tax code contains the basic rules for this game, and once you know the rules, you can apply the correct strategies.

Here's the basic strategy:

- Avoid the high taxes (up to 40.8 percent) on short-term capital gains and ordinary income.
- Lower the taxes to zero—or if you can't do that, then lower them to 23.8 percent or less by making the profits subject to long-term capital gains.

Think of this: you are paying taxes at a 71.4 percent higher rate when you pay at 40.8 percent rather than the tax-favored 23.8 percent.

To avoid the higher rates, here are seven possible tax-planning strategies.

### Strategy 1

Examine your portfolio for stocks that you want to unload, and make sales where you offset *short-term* gains subject to a high tax rate such as 40.8 percent with *long-term* losses (up to 23.8 percent).

In other words, make the high taxes disappear by offsetting them with low-taxed losses, and pocket the difference.

## Strategy 2

Use *long-term* losses to create the \$3,000 deduction allowed against ordinary income.

Again, you are trying to use the 23.8 percent loss to kill a 40.8 percent rate of tax (or a 0 percent loss to kill a 12 percent tax, if you are in the 12 percent or lower tax bracket).

## Strategy 3

As an individual investor, avoid the wash-sale loss rule.

Under the wash-sale loss rule, if you sell a stock or other security and purchase substantially identical stock or securities within 30 days before or after the date of sale, you don't recognize your loss on that sale. Instead, the code makes you add the loss amount to the basis of your new stock. If you want to use the loss in 2020, then you'll have to sell the stock and sit on your hands for more than 30 days before repurchasing that stock.

## Strategy 4

If you have lots of capital losses or capital loss carryovers and the \$3,000 allowance is looking extra tiny, sell additional stocks, rental properties, and other assets to create offsetting capital gains.

If you sell stocks to purge the capital losses, you can immediately repurchase the stock after you sell it—there's no wash-sale "gain" rule.

## Strategy 5

Do you give money to your parents to assist them with their retirement or living expenses? How about children (specifically, children not subject to the kiddie tax)?

If so, consider giving appreciated stock to your parents and your non-kiddie-tax children. Why? If the

parents or children are in lower tax brackets than you are, you get a bigger bang for your buck by

- gifting them stock,
- having them sell the stock, and then
- having them pay taxes on the stock sale at their lower tax rates.

## Strategy 6

If you are going to make a donation to a charity, consider appreciated stock rather than cash, because a donation of appreciated stock gives you more tax benefit.

It works like this:

- **Benefit 1.** You deduct the fair market value of the stock as a charitable donation.
- **Benefit 2.** You don't pay any of the taxes you would have had to pay if you sold the stock.

**Example.** You bought a publicly traded stock for \$1,000, and it's now worth \$11,000. You give it to a 501(c)(3) charity, and the following happens:

- You get a tax deduction for \$11,000.
- You pay no taxes on the \$10,000 profit.

Two rules to know:

1. Your deductions for donating appreciated stocks to 501(c)(3) organizations may not exceed 30 percent of your adjusted gross income.
2. If your publicly traded stock donation exceeds the 30 percent, no problem. Tax law allows you to carry forward the excess until used, for up to five years.



## Strategy 7

If you could sell a publicly traded stock at a loss, *do not* give that loss-deduction stock to a 501(c)(3) charity. Why? If you sell the stock, you have a tax loss that you can deduct. If you give the stock to a charity, you get no deduction for the loss—in other words, you miss out on that tax-reducing loss.

## 2020 Last-Minute Year-End Tax Strategies for Marriage, Kids, and Family

If you are thinking of getting married or divorced, you need to consider December 31, 2020, in your tax planning.

Here's another planning question: Do you give money to family or friends (other than your children, who are subject to the kiddie tax)? If so, you need to consider the zero-taxes planning strategy.

And now, consider your children who are under age 18. Have you paid them for work they've done for your business? Have you paid them the right way?

Here are five strategies to consider as we come to the end of 2020.

### 1. Put Your Children on Your Payroll

If you have a child under the age of 18 and you operate your business as a Schedule C sole proprietor or as a spousal partnership, you absolutely need to consider having that child on your payroll. Why?

First, neither you nor your child would pay payroll taxes on the child's income.

Second, with a traditional IRA, the child can avoid all federal income taxes on up to \$18,400 in income. If you operate your business as a corporation, you can still benefit by employing the child even though both your corporation and your child suffer payroll taxes.

### 2. Get Divorced after December 31

The marriage rule works like this: you are considered married for the entire year if you are married on December 31.

Although lawmakers have made many changes to eliminate the differences between married and single taxpayers, in most cases the joint return will work to your advantage.

**Warning on alimony!** The TCJA changed the tax treatment of alimony payments under divorce and separate maintenance agreements executed after December 31, 2018:

- Under the old rules, the payor deducts alimony payments and the recipient includes the payments in income.
- Under the new rules, which apply to all agreements executed after December 31, 2018, the payor gets no tax deduction and the recipient does not recognize income.

### 3. Stay Single to Increase Mortgage Deductions

Two single people can deduct more mortgage interest than a married couple.

If you own a home with someone other than a spouse, and you bought it on or before December 15, 2017, you individually can deduct mortgage interest on up to \$1 million of a qualifying mortgage.

For example, if you and your unmarried partner live together and own the home together, the mortgage ceiling on deductions for the two of you is \$2 million. If you get married, the ceiling drops to \$1 million.

If you bought your house after December 15, 2017, then the reduced \$750,000 mortgage limit from the TCJA applies. In that case, for two single people, the maximum deduction for mortgage interest is based on a ceiling of \$1.5 million.



## 4. Get Married on or before December 31

Remember, if you are married on December 31, you are married for the entire year.

If you are thinking of getting married in 2021, you might want to rethink that plan for the same reasons that apply in a divorce (as described above). The IRS could make big savings available to you if you get married on or before December 31, 2020.

You have to run the numbers in your tax return both ways to know the tax benefits and detriments for your particular case. But a quick trip to the courthouse may save you thousands.

## 5. Make Use of the 0 Percent Tax Bracket

In the old days, you used this strategy with your college student. Today, this strategy does not work with the college student, because the kiddie tax now applies to students up to age 24.

But this strategy is a good one, so ask yourself this question: Do I give money to my parents or other loved ones to make their lives more comfortable?

If the answer is yes, is your loved one in the 0 percent capital gains tax bracket? The 0 percent capital gains tax bracket applies to a single person with less than \$40,000 in taxable income and to a married couple with less than \$80,000 in taxable income.

If the parent or other loved one is in the 0 percent capital gains tax bracket, you can get extra bang for your buck by giving this person appreciated stock rather than cash.

**Example.** You give your aunt shares of stock with a fair market value of \$20,000, for which you paid \$2,000. Your aunt sells the stock and pays zero capital gains taxes. She now has \$20,000 in after-tax cash to spend, which should take care of things for a while.

Had you sold the stock, you would have paid taxes of \$4,284 in your tax bracket (23.8 percent times the \$18,000 gain).

Of course, \$5,000 of the \$20,000 you gifted goes against your \$11.4 million estate tax exemption if you are single. But if you're married and you made the gift together, you each have a \$15,000 gift-tax exclusion, for a total of \$30,000, and you have no gift-tax concerns other than the requirement to file a gift-tax return that shows you split the gift.

## 2020 Last-Minute Year-End Medical Plan Strategies

All small-business owners with one to 49 employees should have a medical plan in their business. Sure, the tax law does not require you to have a plan, but you should.

Most of the tax rules that apply to medical plans are straightforward when you have fewer than 50 employees.

Here are the six opportunities for you to consider:

1. If you did not obtain a Paycheck Protection Program loan, then you should make sure to claim the federal tax credit equal to 100 percent of required emergency sick leave and emergency family leave payments made pursuant to the Families First Coronavirus Response Act. And as long as you are doing that, make sure to obtain the employee retention tax credit too.
2. If you have a Section 105 plan in place and you have not been reimbursing expenses monthly, do a reimbursement now to get your 2020 deductions, and then put yourself on a monthly reimbursement schedule in 2021.

3. If you want to but have not implemented your Qualified Small Employer Health Reimbursement Arrangement (QSEHRA), make sure to get that done properly now. You are late, so you could suffer that \$50-per-employee penalty should you be found out.
4. But if you are thinking of the QSEHRA and want to help your employees with more money and flexibility, be sure to consider the Individual Coverage Health Reimbursement Arrangement (ICHRA). The ICHRA has more advantages.
5. If you operate your business as an S corporation and you want an above-the-line tax deduction for the cost of your health insurance, you need the S corporation to (a) pay for or reimburse you for the health insurance, and (b) put it on your W-2. Make sure that the reimbursement happens before December 31 and that you have the reimbursement set up to show on the W-2.
6. Claim the tax credit for the group health insurance you give your employees. If you provide your employees with group health insurance, see whether your pay structure and number of employees put you in a position to claim a 50 percent tax credit for some or all of the monies you paid for health insurance in 2020 and possibly in prior years.

## IRS Announces Help with Tax Debt

The IRS on November 9th announced a new program, the Taxpayer Relief Initiative, to help taxpayers who are unable to pay their taxes because of the pandemic. Taxpayers who owe taxes and could not pay have always had options such as installment agreements and offers in compromise, but now they have more options.

The highlights of the Taxpayer Relief Initiative, according to the IRS:

- Taxpayers who qualify for a short-term payment plan option may now have up to 180 days to resolve their tax liabilities instead of the usual 120 days.
- The IRS says it will offer more flexibility for taxpayers who are temporarily unable to meet the payment terms of an accepted offer in compromise.
- The IRS will automatically add certain new tax balances to existing installment agreements for individuals and for business taxpayers who have gone out of business. This will occur instead of having taxpayers' default on their agreements.
- Certain qualified individual taxpayers who owe less than \$250,000 may set up installment agreements without providing a financial statement or substantiation if their monthly payment proposal is sufficient.
- Qualified taxpayers with existing direct debit installment agreements may now be able to use the online payment agreement system to propose lower monthly payment amounts and change their payment due dates.
- Taxpayers who cannot pay can contact the IRS to request a temporary halt in collection efforts, which the IRS will grant if the taxpayer is currently unable to pay.

First-time abatement penalty relief is also available to taxpayers the first time they are subject to the penalty.

## California Prop 19 Planning

### Consider transfer of real estate to children in 2020 before Prop 19 goes into effect February 16, 2021

We are all familiar with Proposition 13 in CA. The increase of a property's assessed value for property tax purposes has been limited to 2% each year, absent a change in ownership. Therefore, families that have been holding real estate for a long period of time likely enjoy relatively low real property tax assessed values. Currently, the parent-child exclusions permit a generational transfer of highly-appreciated property while maintaining annual property taxes at a relatively low rates for as long as the child owns the property.

Proposition 19 passed earlier this month. It will severely limit the principal residence exclusion and eliminate the non-principal residence exclusion entirely, families may wish to consider prioritizing plans to transfer real properties to children now while the current rules are in effect, with specific emphasis on highly-appreciated properties since they leverage the combined benefits of Proposition 13 and parent-child exclusions with maximum effect.

In addition, the federal gift tax exemption is currently at the historic high of \$11,580,000 in 2020. There are speculations that such exemption can be reduced by future acts of Congress.

There are a number of planning strategies to consider in making the current transfer, including using trusts, limited partnerships and limited liability companies. Planning is also possible for future transfers of property should Proposition 19 be passed by the voters. For example, if you plan to obtain property in the near term and wish to transfer such property to your children in the future, you may consider purchasing and holding such property in a legal entity. Depending on the circumstances, this type of planning may allow for the transfer of portions of such legal entity to your children without triggering a

reassessment under current legal entity exclusions, irrespective of the parent-child exclusions. Furthermore, the transfer of partial interests in the legal entity could likely result in valuation discounts in determining the fair market value of the transfer for estate and gift tax purposes.

Proposition 19, the changes will be effective on February 16, 2021 (for the parent-child exclusions), and April 1, 2021 (for the base year value transfer by persons over 55).



### Our Network

If you would like a second opinion regarding your Estate Plan or Financial Investing please contact us. We have attorneys and financial advisors ready to help.

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