Small Business April 2020 – Special Issue

TAX STRATEGIES

Grow your profits—pay less tax

Business Management Daily

This is your LAST ISSUE unless you act now! See page 8 for details.

TaxNews

Substance over form. Have you received a W-2 or 1099 with an error? Check forms carefully to ensure accuracy. If you discover a mistake, contact the payer promptly to obtain a revised form. Also, a payer may issue a corrected form on its own. Don't ignore the change on the 1040 you file with the IRS. The IRS computers match up W-2s and 1099s and could produce an unexpected tax bill.

Share and share alike. If you use an online platform to provide car rides, rent a spare room or furnish other goods or services, you're involved in the so-called "sharing economy." The IRS has posted valuable information about tax issues for these folks, as well as guidance for tax practitioners representing them, on its website (**www.irs.gov**).

Review plan beneficiaries. Review the beneficiaries (primary and contingent) for your qualified retirement plans and IRAs. Regularly update any designations to reflect major changes in your life or significant events (e.g., birth, death, marriage or divorce). *Note:* These designations supersede a will.

Not child's play. Parents may be able to claim the Child Tax Credit (CTC) for children under the age of 17. Currently, the CTC is $2,000, of which up to $1,400 is refundable, subject to phase-out at relatively high income levels. But the child must have a Social Security number—no exceptions.

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Special Issue on New Tax Law

The massive new tax reform law enacted at the end of 2017—the "Tax Cuts and Jobs Act" (TCJA)—is the biggest overhaul of the federal income tax code in more than 30 years. It will have a major impact on individuals and small businesses for years to come. This Special Report over the next few pages covers the main issues in the new tax law.

Spotlight 5 personal tax changes

The TCJA enhances and creates numerous tax breaks for individual taxpayers, but repeals or scales back a slew of others.

Alert: Although the provisions for individuals are generally effective in 2018, most are scheduled to sunset after 2025.

It's going to take time to sort out all the details, but here are 5 key items on the agenda.

1. Cash in on tax cut bonanza. The new law revamps the individual tax rate structure by reducing rates and expanding brackets for upper-income taxpayers.

Previously, the seven tax rates for individuals were 10%, 15%, 25%, 28%, 33%, 35% and 39.6%. Under the TCJA, the new rates are 10%, 12%, 22%, 24%, 32%, 35% and 37%.

In addition, the new tax law changes the Consumer Price Index used for inflation adjustments, producing smaller inflation adjustments than before.

Tip: The new law preserves favorable tax treatment for long-term capital gains and qualified dividends.

2. Embrace the standard deduction. When you file your personal tax

Continued on top of page 2

5 small business tax items

Big business entities, including multinational corporations, are expected to reap the main tax rewards under the TCJA.

Alert: The new law doesn't ignore small businesses. Beginning in 2018, it provides plenty of tax-saving opportunities for small business owners, although you'll also face some tax obstacles.

Unlike the tax provisions for individuals, most business-related provisions in the TCJA are permanent. Here are 5 key tax changes that deserve your immediate attention.

1. Pounce on lower tax rates. Prior to the new law, corporations were taxed under a graduated tax-rate structure with a top rate of 35%. The new law replaces this rate structure with a flat rate of 21%. Thus, the effective tax rate for the majority of C corporations is lowered.

Tip: The TCJA also reduces the dividends-received deduction from 80% to 65% if a corporation owns 20% of the stock of another corporation (from 70% to 50% for others).

2. Max out on Section 179. The TCJA almost doubles the maximum Section 179 expensing allowance from $510,000 for 2017 to $1 million for 2018, and increases the deduction phaseout threshold from $2.03 million for 2017 to $2.5 million for 2018 (plus inflation indexing in future years). Thus, many small businesses

Continued on bottom of page 2

Personal tax changes *(Cont. from page 1)*

return, you have a choice between claiming the standard deduction and itemizing deductions. Now the new law almost doubles the standard deduction to $12,000 for single filers ($12,400 for 2020) and $24,000 for joint filers ($24,800 for 2020). It also preserves the additional standard deductions for the elderly and blind.

Due to the higher standard deduction and related changes, such as the elimination and cutbacks of certain itemized deductions *(see below)*, more upper-income taxpayers are likely to claim the standard deduction.

Tip: The increase in the standard deduction is offset somewhat by the loss of personal and dependent exemption deductions.

3. Don't take it personally. Previously, you could claim a personal exemption for yourself, your spouse (if married) and each of your qualified dependent children or qualifying relatives. Each exemption was scheduled to be $4,100 in 2018. Now the new law eliminates all personal exemptions, including those for dependent children and relatives.

Tip: In conjunction with this change, the personal exemption phaseout rule for higher-income taxpayers is repealed.

4. Keep it all in the family. The new law doubles the child tax credit (CTC) for each qualifying child from $1,000 to $2,000. Of this amount, $1,400 is "refundable" under a late amendment to the law. The TCJA also creates a new $500 credit for nonchild dependents.

Existing credits for adoption expenses and dependent care expenses are retained.

Tip: The new nonchild dependent credit isn't available if you claim the CTC.

5. Give 'til it hurts. If you expect to itemize on your 2019 return, despite the aforementioned changes, you can still benefit from the deduction for charitable donations. Generally, this deduction remains intact, although the new law did make these modifications:

- Previously, the annual deduction for cash donations to public charities was limited to 50% of adjusted gross income (AGI). The TCJA increases this limit to 60% of AGI.
- The tax rule allowing donors to deduct 80% of the cost of donations paid to obtain the right to preferred seating at college athletic events is repealed.
- Substantiation requirements for cash gifts were relaxed if a charity provided the requisite information to the IRS. This exception no longer applies.

Tip: When appropriate, continue donating appreciated property to maximize your deduction.

Online Resource Subscribers have access to upcoming and archived issues detailing additional personal tax changes.

Small business tax items *(Cont. from page 1)*

can currently deduct the entire cost of qualified property placed in service in 2018.

Tip: The deduction is still limited to your income from business activities.

3. Seize bonus depreciation. For the next five years, your business can claim 100% bonus depreciation, up from 50% in 2017, for qualified business property placed in service. After 2022, the deduction is reduced incrementally, as shown below, before it disappears completely after 2026.

Tip: Qualified business property is expanded to include used, not just new, property.

4. Ride in tax luxury. Depreciation deductions for so-called "luxury cars" for business drivers are limited to relatively modest amounts. However, under the new law, the annual limits for luxury cars are boosted. For example, if you acquired a used business car in 2018, the maximum first-year deduction for 100% business use is $10,000. (It was $3,160 in 2017.)

Tip: A business car may also be eligible for bonus depreciation of $8,000.

5. Pass through a deduction. For the first time ever, the owners of many pass-through entities—such as partnerships, S corporations, limited liability companies and sole proprietorships—can deduct 20% of net business income on their personal returns. In effect, you're only taxed on 80% of your small business income. But this provision includes restrictions against gaming the system. Notably, the deduction is phased out for owners of most service businesses, other than architects and engineers. Everyone else—from photographers to plumbers—is covered.

Tip: This restriction doesn't apply to single filers with taxable income up to $157,500 and up to $315,000 for joint filers on 2018 returns.

Online Resource Subscribers have access to upcoming and archived issues detailing additional small business tax items.

Get ready to launch a solo 401(k) retirement plan

Most contributions and other limits for retirement plans didn't budge much for 2018. But some small business owners can take matters into their own hands.

Strategy: Set up a "solo 401(k) plan." If you qualify, you can effectively benefit from both "employee" and "employer" contributions to your account. In many cases, this dual tax winner can't be beat because it often allows you to sock away more money than any other type of retirement plan.

Here's the whole story: With the standard defined contribution plan used by small business owners—such as a Simplified Employee Pension (SEP) or garden-variety profit sharing plan—the employer's deductible contribution in 2020 is capped at the lesser of 25% of compensation or $57,000.

The maximum compensation that may be taken into account for these purposes is $285,000. But that's as far as it goes.

In contrast, an employee participating in a traditional 401(k) plan can make an elective deferral contribution to the plan within the annual limits and the employer may match part of the contribution, usually up to a single-digit percentage of your salary.

A solo 401(k) offers even more. For 2020, you may defer up to $19,500 of compensation to your account, plus an extra catch-up contribution of $6,500 is allowed if you're age 50 or older—the same as with elective deferrals to a traditional 401(k). Of course, the limits on deductible employer contributions still apply, but here's the kicker: Elective deferrals to a solo 401(k) don't count toward the 25% cap. So you can combine an employer contribution with an employee deferral for greater savings.

Example: Big tax winner for small business owner

Let's say you're the sole employee of your company, you're under age 50 and you receive an annual wage of $125,000. The maximum deductible amount you may contribute to a SEP is $31,250 (the lesser of 25% of compensation or $57,000). If you set up a solo 401(k) plan instead, you can defer $19,500 to the account in addition to keeping the maximum $31,250 employer contribution. That gives you a total contribution of $50,750 (below the $57,000 limit). And, since you're the only employee of the company, you don't have to worry about making contributions for anybody else.

The contributions to a solo 401(k) grow tax-deferred until you're ready to make withdrawals. For simplicity, suppose you contribute $50,750 to your account each year for the next 20 years until you retire. If you earn 7% a year, you will have accumulated a whopping nest egg worth $2,226,158!

Conversely, if you contribute $31,250 to a SEP for 20 years instead and invest it at the same 7% rate, you will accumulate $1,281,109 before retirement—or $944,849 less.

If the business isn't incorporated, the 25%-of-compensation cap on employer contributions is reduced to 20% because of the way contributions are calculated for self-employed individuals. But that still leaves you with plenty of room to maneuver.

For instance, if your net self-employment income is $125,000, you can stash away up to $49,000 ($19,000 deferral and $30,000 employer contribution) in the account this year. And remember that contributions can be boosted once you reach age 50.

Note that a solo 401(k) may offer other advantages. For instance, the plan can be set up to allow loans and hardship withdrawals. Also, you might roll over funds tax free from another qualified plan if you previously worked somewhere else.

Tip: Contributions are discretionary. Therefore, you can cut back on your annual contribution—or skip it entirely—if your business is having a bad year.

Going solo: Not a 'free ride'

Despite the obvious benefits, there are a couple of drawbacks to solo 401(k) plans.

1. If your business has any other employees, they may have to be covered under the plan.

2. You have to deal with the hassle and cost of running the plan.

Good news: After the tax rules were changed to favor solo 401(k) plans, more "big players" entered the arena. Now that financial outfits like Fidelity and Smith Barney offer solo 401(k)s, administrative costs have plummeted. Typically, a small business owner might be charged a one-time setup fee of $100 and a small annual administrative fee ranging from $50 to $250.

5 tax tips for gig economy

According to recent data from the Federal Reserve, nearly one out of every three Americans is involved in the gig economy (aka "sharing economy").

Strategy: Find out about the tax consequences. Workers in the gig economy have tax obligations and opportunities similar to those of other self-employed individuals.

Notably, you must pay taxes on your earnings, but you could be entitled to some offsetting deductions.

Here are 5 tax tips that can help you avoid problems and maximize available tax benefits.

1. Don't hide taxable income. 'Fess up to the IRS about the earnings from your gig, even if it's only a sideline business. For instance, if you receive payment in the form of money, goods, property or services, the income is taxable on your personal return. In addition, separate cash tips must be treated as taxable income. See IRS Pub. 334, *Tax Guide for Small Business*, at **www.irs.gov/pub/irs-pdf/p334.pdf**, for more details.

2. Report large cash transactions. Any business taxpayer, including a participant in the gig economy, who receives more than $10,000 in cash in a single transaction (or in a series of related transactions) is required to file Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business*, within 15 days after receiving payment.

3. Green light biz deductions. As a general rule, you can deduct ordinary and necessary business expenses incurred as a participant in the sharing economy, including deductions for your vehicle if you're an Uber or Lyft driver. For 2020, you can use a flat rate of 57.5 cents per business mile (down from 58 cents per mile in 2019), plus related tolls and parking fees, instead of deducting your actual expenses. Similarly, an Airbnb landlord can write off most business expenses. Typically, the deductions are claimed on Schedule C as a self-employed.

4. Avoid estimated tax penalty. If you're participating in the gig economy, you will have to make quarterly installment payments of "estimated tax" or adjust your withholding from another job, or both. Use Form 1040-ES, *Estimated Tax for Individuals*, to help figure out these payments. Generally, to avoid an estimated tax penalty, you must pay at least 90% of your current year tax liability or 100% of the prior year's liability (110% if your AGI for the prior year exceeded $150,000).

5. Keep good records. Recordkeeping is essential for tracking taxable income and deductible expenses. This also helps you substantiate claimed deductions if the IRS ever challenges them. Your recordkeeping system should include a summary of all business transactions. Generally, it is best to record transactions on a daily basis.

Want to know more? The IRS has created the "Sharing Economy Resource Center" at **www.irs.gov/businesses/small-businesses-self-employed/sharing-economy-tax-center**. It is designed to provide assistance to taxpayers participating in the gig economy.

Tip: You can also view a YouTube video at **www.youtube.com/watch?v=JlS7nxN6mxE**.

Lessons from the Tax Court: Is tax professional guilty of fraud?

To add insult to injury, wayward taxpayers can also be assessed fraud penalties in addition to forfeiting unsubstantiated deductions. However, for fraud penalties to stick, the IRS must provide "clear and convincing evidence" that the taxpayer underpaid tax, due at least partially to fraud.

Having some expertise in tax return preparation isn't enough, by itself, to warrant fraud penalties when the IRS disallows deductions.

New case: The taxpayer operated a tax-related business for over 30 years, preparing tax returns for the past 20 years. When he was starting out, he attended college courses on tax concepts and seminars on tax preparation. Furthermore, the taxpayer initially had a second job helping a CPA prepare tax returns, plus another job as an accountant for two other businesses.

In the course of his business activities, the taxpayer prepared hundreds of income tax returns between 2006 and 2008. He also prepared the joint tax returns filed for himself and his spouse.

The taxpayer claimed numerous business expense deductions for the tax years in question. Upon audit, the IRS determined that the taxpayer had failed to report $4,905 and $5,552 in business income in 2006 and 2008, respectively. It assessed both fraud and accuracy-related penalties.

Tax outcome: The Tax Court found that the taxpayer's overall education and experience didn't justify the fraud penalty. It said that the IRS didn't offer convincing proof of his sophistication and expertise. In addition, the court determined that the taxpayer was misguided in his understanding of several areas of tax law.

The Court concluded that the taxpayer failed to maintain adequate business records and documentation to support claims for business deductions. But the failure wasn't part of a concerted plan to conceal, mislead or otherwise prevent the collection of tax. Therefore, it disallowed the deductions but negated the fraud penalty. (*Ericson,* TC Memo 2016-107, 6/1/16)

Skirt NII surtax on family business interests

If you sell your business, you might owe a hefty income tax on the appreciated interest. Saving grace: You might avoid the 3.8% Medicare surtax on net investment income (NII), depending on the exact circumstances. But what about your kids and other family members who are shareholders? They could get walloped by the surtax.

Strategy: Hire family members who are co-owners (if they don't already work for the company). Keep them on the payroll until you sell the business. As a result, when the deal finally closes, the relatives with business interests should be able to squeeze through the same tax loophole as you, the business owner.

Here's the whole story: The 3.8% surtax applies to the lesser of NII or the excess above modified adjusted gross income (MAGI) of $200,000 for single filers and $250,000 for joint filers. For this purpose, NII interest, dividends, royalties, rents, gains from dispositions of property and income from passive activities qualify, but not tax-free interest or distributions from qualified retirement plans and IRAs.

Another exclusion from the definition of NII is critical to many family-owned businesses. It specifically doesn't include gains from the sale of property owned in an active trade or business that is not a C corporation. That lets many owners who operate their businesses as sole proprietorships, LLCs, partnerships and S corporations off the hook. However, owners of these businesses who sit on the sideline will have to face the surtax if the business is sold.

Example: Your small business is operated as an S corp and is currently valued at $12 million with an adjusted basis of $2 million. You and your spouse own 80% of the business and the remaining 20% is split evenly between your two adult children, a son and a daughter. So each child currently owns shares worth $1.2 million with a basis of $200,000.

Your son already works for the company, but your daughter doesn't. If you sell the business for $12 million, each child will recognize a taxable gain of $1 million ($1.2 million–$200,000).

According to the regulations, the gain from the sale won't count as NII for your son because he is a material participant in the business. But your daughter will probably owe the 3.8% surtax on at least $1 million of NII (not even counting investment income from other sources). That comes to $38,000 on top of the regular income tax!

This harsh result can easily be avoided if you hire your daughter to work for the business. Your daughter will owe taxes on wages, but will be eligible for tax-free fringe benefits.

Tip: The job must be legitimate—surtax can't be avoided just by putting a child on the books.

Business

Squeeze under interest deduction cap

Generally, the Tax Cuts and Jobs Act (TCJA) favors businesses, with several exceptions.

Strategy: Watch out for a new deduction limit for business interest. Under the TCJA, this deduction can't exceed 30% of an affected business's adjusted taxable income (ATI). However, your small business may qualify for an exception that avoids the new interest deduction limit.

Here's the whole story: The TCJA limits a business's annual "net interest" deduction to 30% of ATI. The new limit potentially applies to corporate and non-corporate businesses alike. Net interest is defined as the amount of business interest paid or accrued during the year less the amount of business interest income for the year.

For these purposes, ATI is your business's federal taxable income without counting:

- Income, deduction, gain or loss not properly allocable to a business activity
- Business interest income and expense
- Net operating loss deductions
- The new deduction for up to 20% of qualified business income from pass-through entities
- For tax years beginning before 2022, allowable deductions for depreciation, amortization or depletion.

Key exception: The new 30%-of-ATI business interest expense limit does not apply to a business with average gross receipts of $25 million or less for the three prior tax years. Other exceptions may be available (e.g., for certain real estate operations and farms). If you're hit by the business interest limit, at least you can still carry forward the disallowed amount indefinitely until it can be deducted.

Tip: Special rules apply to pass-through entities. See your tax pro.

Step forward to receive charitable deductions for good deeds

You can't deduct the cost of the time and effort you spend on behalf of charity. But that doesn't mean your good deeds will go for tax naught.

Strategy: Track your out-of-pocket costs. Even though you can't deduct the value of your endeavors, itemizers can write off actual expenses associated with charitable activities.

This tax break is available to regular volunteers and others who help out sporadically.

Furthermore, you don't have to be a board member or one of the charity's biggest donators. This tax break is available to regular volunteers and others who help out sporadically.

What sort of expenses are we talking about? Here's a partial list.

- **Transportation:** If you use your car for charity, deduct the related costs attributable to gas and oil, repairs, insurance, etc. *Alternative:* You might opt for the flat-rate deduction of 14 cents per mile (plus related parking fees and tolls). Similarly, you can deduct plane, train or bus costs for traveling to charitable events.
- **Telephone charges:** You may deduct the full cost of long-distance telephone calls, faxes and cellphone charges made on behalf of a charity. If you install a landline in your home that you use solely for charitable purposes, the entire cost is deductible.
- **Home entertainment:** If you host a fundraiser or board meeting, you can deduct the entire cost of the catering expenses as a charitable deduction. *Note:* The 50% limit on entertainment and meal expenses doesn't apply here.
- **Fundraising dinners:** Normally, you can deduct the portion of the cost that exceeds the fair market value of a fundraising dinner. For example, let's say you and your spouse attend a dinner that costs $100 a head. If the meal is valued at $35 a head, you can deduct $130 ($200 cost – $70 value). *Note:* For amounts exceeding $75, obtain written documentation from the charitable organization.
- **Uniforms:** A deduction is allowed for the cost of uniforms used while performing charitable services as long as the clothing isn't suitable for everyday wear. *Classic example:* You can write off the cost of Boy Scout or Girl Scout uniforms.
- **Foreign exchange students:** If you host a foreign exchange student in your home, you can deduct up to $50 per month for each month the child attends high school. To qualify, the student must live in your home under a written agreement with a qualified charity. Also, the exchange student can't be a relative.
- **Charitable conventions:** You may be able to deduct the cost of attending a convention on behalf of a charity—such as meals and lodging—if you're an official delegate to the convention. But the convention must be the primary purpose of the trip. The deductible amount includes meals and lodging while you attend the convention. *Caveat:* The cost of any side trips to tourist attractions isn't deductible.

Tip: Individually, these deductions may be small, but collectively they add up. Keep the records you'll need at tax return time.

Contribute IRA funds to charity

Certain older taxpayers may be able to benefit from a unique tax break.

Strategy: Transfer funds directly from an IRA to an IRS-approved charity. Although the charitable contribution isn't deductible, the distribution from the IRA isn't taxable. And the payout qualifies as a required minimum distribution (RMD).

This strategy is only available to taxpayers over age 70½. Congress threatened to remove this tax break as part of the Tax Cuts and Jobs Act (TCJA). But, ultimately, the new law didn't touch it.

Tip: If you have both a traditional IRA and a Roth IRA, it generally makes sense to use the traditional IRA first for qualified charitable distributions.

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Small Business Tax Strategies (ISSN 1935-1992) is published monthly by Business Management Daily, 7600A Leesburg Pike, West Building, Suite 300, Falls Church, VA 22043-2004, (800) 543-2055, **www.SmallBizTax.net**. Annual subscription price: $299.
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Thinking about a real estate swap? Use a go-between

Under the new Tax Cuts and Jobs Act (TCJA), like-kind exchanges of commercial or investment real estate properties remain exempt from tax. However, things usually aren't so cut-and-dried in the real world. For one thing, it's unlikely the potential buyer of your property will own any real estate you desire.

Strategy: Use a "qualified intermediary" to facilitate deals. The intermediary can be inserted in the middle of a multiple-party exchange. In the end, you wind up with a property you want.

Like-kind exchanges involving multiple parties are often called "Starker exchanges" after the landmark case approving their use. *(Starker, 602 F2d 1341, 9th Cir., 1979)* As long as you meet the tax law rules and deadlines for a Starker exchange, you can swap property tax free.

Here's the whole story: The tax law definition of like-kind real estate property is a relatively liberal one. It refers to the nature of the property, not its quality or grade. For example, you can swap a warehouse tax free for an apartment building or even raw land. You owe tax only to the extent you receive any "boot" as part of the deal (e.g., cash or reduced mortgage liability or property that is not like-kind).

But there are two key time restrictions:

1. The property that you will receive in the exchange must be identified within 45 days of transferring the property.

2. The property must be received within the earlier of 180 days after the transfer or the due date of the tax return for that year (including any extensions of the due date).

Fortunately, a qualified intermediary can help you overcome these timing hurdles.

Example: You use a qualified intermediary for a Starker exchange involving four parties. Technically, you (the first party) sell the property you're relinquishing to a cash buyer (the second party). But the cash buyer pays the intermediary (the third party) instead of you. The intermediary holds the proceeds until you identify a suitable replacement property.

At that point, the intermediary uses the sales proceeds to buy the replacement property from its owner (the fourth party). Finally, the intermediary transfers this property to you to complete the like-kind exchange.

The tax law definition of like-kind real estate property is a relatively liberal one. It refers to the nature of the property, not its quality or grade.

For tax purposes, you're considered to have swapped properties tax free with the intermediary. That's because no cash actually exchanges hands (except to the extent cash boot is involved). The intermediary handles the funds on your behalf.

To qualify for tax-free treatment, you and the qualified intermediary must sign a "Qualified Exchange Accommodation Agreement." The agreement should state that the intermediary is holding the property to facilitate a tax-free exchange. The intermediary must also agree to meet all the technical reporting requirements spelled out by the IRS.

Tip: Qualified intermediaries generally charge fees based on the value of the properties. Factor this into your decisions.

IRS carves out safe-harbor rule

The IRS has approved a "safe-harbor rule" for participants in a Starker exchange when a qualified intermediary defaults due to bankruptcy. *(IRS Revenue Procedure 2010-14)*

The upshot: If you satisfy the requirements, you won't be taxed on any of the proceeds until the intermediary emerges from bankruptcy. The safe-harbor rule applies if you:

- Transferred relinquished property to the intermediary in accordance with the regs
- Properly identified replacement property within the identification period (unless the default occurs during that period)
- Failed to complete the like-kind exchange solely because of the default involving a bankruptcy or a receivership
- Did not have actual or constructive receipt of proceeds from any property of the intermediary prior to the bankruptcy or receivership.

Tip: Any gain will then be realized under a gross profit ratio method. See your tax professional.

Mail Call

Meal and entertainment expenses

Q I received an invitation for a free meal at an investment seminar. Is this taxable, if I go? *B.R., Tinton Falls, N.J.*

A No. The event is governed by the general tax rules for meal expenses. Therefore, as the recipient of the meal, you don't owe any income tax on this benefit. But it's not completely "free." Undoubtedly, you'll have to listen to a sales pitch from a financial planner, plus you may have to endure follow-up contacts.

Tip: If you pay to attend an investment seminar or convention, you can't deduct the cost, either.

Home office deductions: Stand on firm ground

Q In a previous issue, you stated that you could deduct home office expenses based on the number of rooms in the home. Do you have any authority for this statement? *J.R.M., Largo, Fla.*

A Yes. Typically, home office deductions are based on the percentage of business use (square footage of the business portion of the home divided by the total square footage). But the IRS says in Publication 587, *Business Use of Your Home*, a taxpayer *can* base the percentage on the number of rooms if the rooms are about the same size. Say you use one room of an eight-room house for business. The room is 300 square feet out of a total of 3,000 square feet. In this case, the "rooms method" (12.5%) yields a bigger deduction than the square-footage method (10%).

Tip: Access Publication 587 at **www.irs.gov/pub/irs-pdf/p587.pdf**.

Tap unique tax break on company stock

Q When my friend retired several years ago, she didn't roll over her company stock into an IRA. (She had bought some of the stock and her employer gave her some.) If she sells the stock, will it be taxed as capital gain? *F.G., King of Prussia, Pa.*

A Partially. Assuming your friend holds the company stock in a qualified retirement plan, she's eligible for a unique tax break: If a retirement plan distribution is paid in company stock, the retiree is taxed at ordinary income rates on the stock's original cost. Any appreciation is untaxed. When she sells it, the difference between the sales price and the original cost is taxed as capital gain.

Dividing the spoils of a spousal IRA

Q I retired in 2018, but my wife is still working. I'm now 68, and my wife is 62. We both have IRAs and we file a joint tax return. Can we both still contribute to our IRAs this year? *A.K., Margate, N.J.*

A Yes. Since you qualify for a "spousal IRA" and you're both over age 50, you have until April 15, 2021, to jointly contribute up to $14,000 to your IRAs for 2020 (assuming either of you earned at least that much in compensation during the year). That maximum $14,000 contribution can be divided among your IRAs in any manner in which you see fit as long as no more than $7,000 is allocated to either account. You have until your tax return due date to make the annual contribution.

Tip: To delay mandatory distributions from the IRA, allocate more of the contribution to the younger spouse.

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