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The CFO Advisor

Guidance for Small Business Success™

Time is running out to minimize your tax obligation before the end of the year! This month's newsletter features several tax moves to consider making by December 31st to lessen the amount of money you owe the IRS.

Many small businesses navigated a downturn in revenue and profits over the past 24 months. If your business ever finds itself in the red, it's at least good to know that you can use that loss against future income for tax purposes.

The rules for how you can use your business' losses to offset future taxable income, however, have gone through several changes over the past few years. In this month's newsletter, we explain what you need to do to take advantage of your business' net operating loss.

Merry Christmas and a Happy New Year!

Dwight L. Hulse, CPA/CITP,CGMA

Year-End Tax Planning Ideas For Your Business

Here are some ideas to lower your business taxes, get organized, and to prepare for filing your 2021 tax return.

As 2021 winds down, here are some ideas to consider in order to help manage your small business and prepare for filing your upcoming tax return.

- **Identify** all vendors who require a 1099-MISC and a 1099-NEC. Obtain the tax identification numbers for each of these vendors.
- **Determine** if you qualify for the Paycheck Protection Program safe harbor threshold that allows you to deduct certain 2020 expenses on your 2021 tax return.
- **Consider** accelerating deductions or deferring earnings, based on profit projections.
- **Section 179,** or bonus depreciation expensing versus traditional depreciation, is a great planning tool. If using Section 179, the qualified assets must be placed in service prior to year-end.
- **Business meals** are 100% deductible in 2021 if certain qualifications are met. Retain the necessary receipts and documentation that note when the meal took place, who attended, and the business purpose of the meal on each receipt.
- **Consider** any last-minute deductible charitable giving including long-term capital gain stocks.
- **Review** your inventory for proper counts and remove obsolete or worthless products. Keep track of the obsolete and worthless amounts for a potential tax deduction.
- **Set-up** separate business bank accounts. Co-mingling business and personal expenses in one account is not recommended.
- **Create** expense reports. Having expense reports with supporting invoices will help substantiate your tax deductions in the event of an audit.

"Remember our former product, 'The Resolution', that people only used on January 2nd of each year?"

- **Organize** your records by major categories of income, expenses, and fixed assets purchased to make tax return filing easier.
- **Review** your receivables. Focus on collection activities and review your uncollectable accounts for possible write-offs.
- **Make** your 2021 fourth-quarter estimated tax payment by January 18, 2022.

New Rules Could Limit Your Business Losses

Here's what you need to know about net operating losses starting in 2021.

It's never fun to lose money, but business losses are tax-deductible. Unfortunately, the rules for deducting losses have undergone multiple changes over the past few years, and more changes could be coming. Here's where things stand now.

Background

If a business' deductions exceed its income, it has a net operating loss (NOL) for the year.

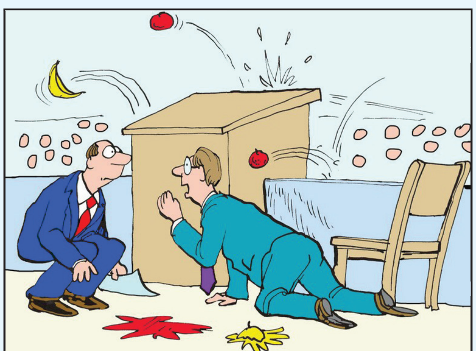
Example:: Brandon earned $80,000 in income from his sole proprietorship business. He had $100,000 in expenses and no other income. His NOL is $20,000.

You'll owe no income tax the year you have an NOL. But you can also use an NOL to reduce taxes in other years when your business does turn a profit.

NOLs for 2018 through 2020

NOLs incurred during 2018 through 2020 can be carried back five years. That is, you can apply an NOL to prior tax years by filing an application for a refund or amending a prior year tax return. This enables you to get a quick refund from the IRS for all or part of the taxes paid in previous years. Any remaining NOL is then carried forward indefinitely until used up. NOLs for these years may offset 100% of taxable income to reduce your tax liability to zero.

Example: Assume that Brandon incurred his $20,000 NOL in 2020. He may carry it back to 2015 to reduce his taxable income for that year and obtain a refund of up to 100% of the tax he paid. If he has any NOL amount remaining, it is applied to his 2016 through 2019 tax years in turn. Any remaining NOL is then applied to 2021 and any number of future years. Alternatively, Brandon could elect to only carry his NOL forward to 2021 and future years.



"The announcement of the changes really went well."

NOLs for 2021 and Later

Starting with the 2021 tax year, the NOL rules are much more restrictive:

- You may only deduct NOLs for the current year and any number of future years. You may not carry them back to deduct in prior years and get a refund.
- NOLs for these years may only offset up to 80% of taxable income for any year.
- For 2021 through 2026, NOLs are subject to an annual limit of $262,000 for individual taxpayers and $524,000 for married taxpayers filing jointly. Losses over these amounts must be carried forward.

Example:: Assume that Brandon incurred his $20,000 NOL in 2021. He may not carry it back to reduce his taxes for any past years. He may only apply the NOL to 2022 and later, offsetting up to 80% of his taxable income for that year.

Strategies to Deal with New NOL Rules

Since you can't carry NOLs back, consider creating more taxable income for the NOL year so you can make immediate use of your loss:

- Convert your traditional IRA to a Roth IRA if your business is a flow-through entity. The conversion amount is taxable income you can offset against your NOL on your personal tax return.
- Take a taxable distribution from your traditional IRA (but only if you don't have to pay any penalties).

Example:: Brandon converts $20,000 from his traditional IRA into a Roth IRA. The $20,000 offsets his $20,000 2021 NOL because these business losses flow to his personal tax return, resulting in zero net taxable income for the year.

Please call your tax specialist if you have any questions about an NOL for your business.

Are You In Need of a Trusted Business Advisor?

If you are not my client and would like to explore whether we might be a good fit, please contact me. As an experienced business advisor, I have worked not only in private and public industries but also across many functional areas and can help you implement best practice solutions to improve profits.

Do You Have A Tough Accounting / Finance Question You Want Answered?

I love hearing from my small business clients and friends who enjoy reading my monthly newsletter. I'm always looking to answer pressing questions you might have relating to small business. If you have a question, tip or idea, please call me at 352-450-2880 or email me at dwight@dlhulseconsulting.com. Perhaps I'll feature you in a future issue!

Should You Invest in Rental Real Estate?

If you want to make a profit by investing in rental real estate, you must be willing to commit more resources to this property than you would to an investment made at your bank, through a broker, or in a mutual fund.

Someone has to collect rents, find good tenants, and maintain the property. If you hire help to do these tasks, your profit shrinks.

Also, if you borrow money to buy the property, you have to pay the mortgage whether or not the property is rented. You should have emergency funds so that you will not lose the property to foreclosure if you lose your tenant.

If you decide to invest in rental property, you may need professional help to match your resources to property that will meet your goals. Some of the questions you should consider before you invest:

- **What can you afford?** Determine the highest price range you can sustain, given your present resources and the projected cash flow from the property.
- **Is the property fairly priced?** Get a list of comparable listings and recent sales from a real estate company. Make any purchase offer contingent on the results of structural and pest inspections. Check local records to verify that additions and major improvements were made in compliance with building codes.
- **Are there any restrictions on the property?** Rent control will lower the price that you can afford to pay for a property.
- **Who will be your tenants?** Evaluate the likelihood of nonpayers, transients, and untidy housekeepers — and adjust your price accordingly. If you are buying a condominium in a building populated with young people, you may find it difficult to interest a retired couple (if that's your market) in living in the unit.

Investing in rental property can be very profitable, but you should be fully informed before you invest, or you could end up with more work and less return than you anticipated.

Avoid Tax Traps in Loans to Friends and Family

Lending to friends and relatives is a tricky business, and not only because of the stress it can place on your relationships. There are tax issues involved as well. If you have to lend money to someone close, here are some tips to do it right in the eyes of the tax code.

Charge interest

Yes, you should charge interest, even to friends and family. If you don't charge a minimum rate, the IRS will imply interest in the loan and tax you for the interest they assume you should be getting. This can occur even if you're not actually getting a dime.

Charge enough interest

Not only should you charge interest, the amount must be reasonable in the eyes of the IRS. If it's not, the IRS will imply interest at their minimum applicable federal rates (AFRs). To stay on the safe side, always charge an interest rate at or above these AFRs, available on the IRS' website. The good news is these interest rates are low and almost always below the prime interest rate.

Know the exceptions

If you don't want to charge interest, you don't have to IF:

- The money is a gift. You and your spouse can each give up to $15,000 to an individual each year (this maximum remains $15,000 in 2019).

OR:

- The loan is less than $10,000 and is not used to purchase income-producing property.

If you don't charge interest and the loan is used to purchase income-producing property such as capital equipment or to acquire a business, special tax rules apply. In this case it's good to ask for assistance.

Get it in writing

If you expect repayment, write out the terms of your loan. There are a variety of basic loan document formats online that you can use. Creating a loan document may seem unnecessarily formal when dealing with a friend or family member, but it's important for two reasons.

1. It documents your tax code compliance. By documenting the terms and charging a stated interest rate you can clearly show you are within tax code rules.

2. You avoid misunderstandings. Creating a written document will make it clear that it is a real loan, not an informal gift. Your friend or relative will know that you expect to be paid back and when you expect repayment.

Quotes:

"If there is hope in the future, there is literally power in the present." — *Zig Ziglar*

"The greatest cause of human financial struggle is the fear of losing money." — *Robert Kiyosaki*

"I do the very best I can to look upon life with optimism and hope and looking forward to a better day." — *Rosa Parks*

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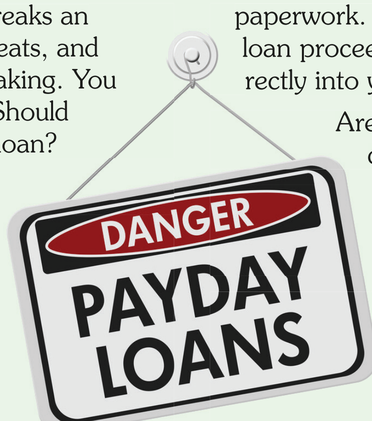
See What's Inside...

Payday Loans: A Good Idea?

Your daredevil kid breaks an arm, the car overheats, and the house roof starts leaking. You need cash right away. Should you consider a payday loan?



Payday loan basics

Payday loans (sometimes called cash advance or deferred deposit loans) can provide short-term financing to help cover immediate needs. You can usually apply online or at a local storefront.

Here's how it typically works: You write the lender a post-dated check for the loan amount plus a borrowing fee. The lender hands you a check and agrees to hold your post-dated check until next payday. When payday rolls around, the lender deposits the post-dated check or you extend the loan for an additional fee.

If you apply online, you'll often be approved in minutes without filling out paperwork. In a few hours or days, loan proceeds will be deposited directly into your bank account.

Are payday loans a good deal?

It depends. Before you apply, consider three disadvantages:

- **Borrowing costs are high.** The interest rate on a two-week loan is typically 15-30 percent. Extend the loan for a year, and you may be paying more than 300 percent in interest.
- **Some lenders are unscrupulous.** Loan shops are popping up in many neighborhoods, and crooks sometimes use them to engage in identity theft.
- **Root problems are not addressed.** Habitually relying on payday loans can exacerbate poor financial habits.

Before an emergency strikes, take time to explore alternatives. Cut back on unnecessary expenses. Ask family and friends for help. Build an emergency fund by working a second job or perhaps selling good-condition items online.

Bottom line? If you certainly must, use a high-interest payday loan as an absolute last resort.

"I wonder if this will effect our Social Security checks."