



# Newsletter

DECEMBER 2021

*Freddi Eberhart & Associates Inc. would like to thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time. Also, thank you for recommending us to your family, friends, and associates. We truly appreciate your referrals.*

## **This Month:**

### **Upcoming dates:**

#### **December 25**

- Christmas Day

#### **December 26**

- Kwanzaa begins

#### **January 18**

- 4th Quarter Estimated Payments Due

### **Take final year-end actions**

- Deductible gifts - Capital gains/losses - Charitable giving - Dividend income

**\*\*\* Federal Legislation Update - “Build Back Better Act” (BBB) is still currently held up in congressional negotiations. Stay tuned...**

Please read about S corporation reasonable compensation, about tax court cases that have great tax messages for all of us, five great money tips, and a few facts about where the government gets and spends its money.

Please call if you would like to discuss how this information could impact your situation. If you know someone who could benefit from this newsletter, feel free to send it to them.

## **IRS Is Cracking Down on Reasonable Compensation**

In a recent report from the Tax Inspector General for Tax Administration (TIGTA), it was recommended that the IRS increase their evaluation of compensation paid to S corporation owners. Currently, very few S corporations are reviewed by the IRS for employment tax compliance, and even fewer are assessed for reasonable compensation paid to the owner(s). This report from the TIGTA estimated that between 2016 and 2018, \$3.3 billion in FICA taxes was avoided by owners taking

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## IRS Is Cracking Down on Reasonable Compensation (Cont'd)

distributions in place of officer compensation. If you are an owner of an S corporation, make sure you review and adjust your compensation prior to December 31<sup>st</sup>, as we are likely to see an increase in reasonable compensation audits in the next couple of years.

## Court Is In Session-Notable Tax Court Cases

Despite the COVID-19 pandemic, political unrest and severe weather events, the Tax Court has continued to churn out decisions affecting individual and business taxpayers. Here's a brief sampling of several cases that may be of particular interest.

- **Coming Up Aces.** (*Coleman, TC Memo 146, 10/22/20*) You can generally deduct gambling losses up to the amount of your winnings from gambling activities if you can provide proper documentation. Now the Tax Court has allowed one taxpayer to estimate his expenses absent proper documentation.

*Facts:* A compulsive gambler was able to show that he likely spent the money from a \$150,000 personal injury settlement in local casinos. The gambler, however, didn't have the usual records to substantiate his claims. The Court allowed an estimated deduction because it was clear he had incurred significant expenses. The gambler was able to net his \$350,000 in gambling winnings with \$350,000 in estimated gambling losses.

*Tax Tip:* Save documentation for all your tax deductions, including gambling winnings and losses. Don't rely on a tax court ruling!

- **Home (Not) Sweet Home.** (*Soboyede, TC Summ. Op. 2021-3, 1/26/21*) Your tax home for deducting travel expenses isn't necessarily the place where you live. It's the general area of your primary workplace.

*Facts:* The taxpayer was an attorney with separate law practices in Minnesota and Washington, D.C. He deducted his hotel expenses and other travel costs in the D.C. area. But his records showed he actually spent more than 50% of his work time in or near the D.C. location. The Tax Court concluded that the attorney's tax home is actually in D.C. As a result, he couldn't deduct his hotel and other expenses from the D.C. area.

*Tax Tip:* You can deduct travel expenses only away from your tax home. If you work in multiple locations, be sure you know which location the IRS considers to be your tax home.

- **Skidding Off The Race Track.** (*Berry, TC Memo 2021-42, 4/7/21*) A business can deduct

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## Court Is In Session-Notable Tax Court Cases (Cont'd)

advertising and marketing expenses that are related to its business activities. No write-off is allowed, however, for personal expenses.

*Facts:* A father and son who owned a construction company were race car enthusiasts. They deducted expenses for the son's racing activities that were incurred as an advertising and marketing expense of the construction company. The Tax Court disallowed the deduction, ruling the expenses were a hobby expenditure, not an ordinary and necessary business expense that can be deducted for tax purposes.

*Tax Tip:* Understand what is considered an ordinary and necessary business expense by the IRS and know whether your activity is deemed to be either a hobby or a for-profit business enterprise.

- **A Slight Understatement.** (*Pragrias, TC Memo 2021-82, 6/30/21*) The IRS normally has three years from the due date of a tax return to conduct an audit of that return. This three-year period is extended to six years, however, if the tax return omits more than 25% of taxable income.

*Facts:* The taxpayer received \$4.9 million from a complex investment but reported only about \$1.5 million. The IRS audited the return after three years. Despite the taxpayer's contention that he didn't omit taxable income - he said he merely understated it - the Tax Court ruled that the longer six-year limit applies. And as a general rule, there is no statute of limitations for the IRS when fraud is involved.

*Tax Tip:* Understand the applicable statute of limitations with your tax returns.

Please call if you have any questions about these tax court cases or any other circumstances that you think apply to your tax situation.

## Five Great Money Tips

Creating a sound financial foundation for you and your family is anything but easy. With low interest rates as an incentive to borrow more and even lower interest rates on savings accounts is it any wonder that it's tough to retain the discipline to save? Here are five thoughts that may help.

1. **Pay yourself first.** Treat saving money with the same care you pay your bills. Take a percentage of everything you earn and save it. Using this technique can help build an emergency fund and keep you from living paycheck to paycheck.

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## Five Great Money Tips (Cont'd)

2. **Know and use the Rule of 72.** You can roughly calculate the number of years compound interest will take to double your money using the Rule of 72. Do this by dividing 72 by your rate of return to estimate how long it takes to double your money. For example, 10% interest will double an investment in 7.2 years; investments with an 8% return will double in nine years. Use this concept to understand the power of saving and investment.
3. **Use savings versus debt for purchases.** Unpaid debt is like compound interest but in reverse. For instance, using a 12% interest credit card to pay \$1,500 for home appliances costs over \$2,000 if paid back over 5 years. The result is that you have to work harder and earn more to pay for the items you purchase. A better idea may be to save and then buy your dream item.
4. **Understand amortization.** When a bank loans you money, it gives you a specific interest rate and a set number of years to pay it back. Each payment you make contains interest as well as a reduction of the amount owed, called principal. Most of the interest payments are front-loaded, while the last few payments are virtually all principal. Making additional principal payments at the beginning of the loan's term will decrease the amount of interest you pay to the bank and help you pay off the loan more quickly.
5. **Taxes are complex and require help.** Tax laws are complicated. They are made even more complex when the rules change, often late in the year. Even worse, the IRS is not in the job of telling you when you forget to take a deduction. The best way to stay out of the IRS spotlight AND minimize your taxes is to ask for help.

## JUST THE FACTS: Borrowed Money Must Be Paid Back

In the back of every Form 1040 instruction booklet there's a section that shows where our federal government gets its money and where it is spent. As taxpayers, it makes sense to know this information. Here is the data for the government's fiscal year ending September 30, 2019, as reported by the IRS in the 2020 instruction booklet for Form 1040. Please note that this spending is prior to COVID-19 relief bills.

### FY Ending 2019

<b>Inflow:</b>	<b>\$3.464 trillion</b>
<b>Outflow:</b>	<b>\$4.448 trillion</b>
<b>Deficit:</b>	<b>\$984 billion</b>

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## JUST THE FACTS: Borrowed Money Must Be Paid Back (Cont'd)

### TOTAL INFLOWS

39%	Personal Income Taxes
28%	Social Security, Medicare, Unemployment Taxes
22%	Borrowing to Cover Deficit
6%	Excise, Customs, Estate, Gift and Misc Taxes
5%	Corporate Income Taxes

### SPENDING BREAKDOWN

- 42% **Social Security, Medicare, & other retirement.** These programs provide income support for the retired and disabled and medical care for the elderly.
- 21% **National defense, veterans, and foreign affairs.** About 15% of outlays were to equip, modernize, and pay our armed forces and to fund national defense activities; about 4% were for veterans benefits and services; and about 1% were for international activities.
- 21% **Social programs.** About 15% of total outlays were for Medicaid, SNAP (formerly food stamps), TANF, SSI; and 6% for health research and public health programs unemployment compensation, assisted housing, and social services.
- 8% **Net interest on the national debt (at historically low interest rates).**
- 6% **Physical, human, and community development.** These outlays were for agriculture and environment; transportation; aid for education and college assistance; job training; deposit insurance, commerce and housing credit; and space, energy, and general science programs.
- 2% **Law enforcement and general government.**

SOURCE: IRS publication i1040gi, P.110, 2020 Tax Year

### What You Need To Know

- **Deficits of \$1 trillion are not sustainable.** No matter where you fall on the political spectrum, annual deficits of \$1 trillion cannot be sustained. And remember, this information is detailing a

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## JUST THE FACTS: Borrowed Money Must Be Paid Back (Cont'd)

pre-pandemic deficit. It may be several more years before the annual deficit gets back down to this level, if at all.

- **Government borrowing hurts all taxpayers.** In 1990, \$50,000 worth of Certificates of Deposits (CDs) earned a cool 8% interest, or \$4,164, each year. Today, that same \$50,000 earns just 0.6%, or \$301. What happened to the other \$3,863? Your interest income is now helping to cover money borrowed by the government in the form of lower interest rates. Look at 2019...almost 1/4 of the money spent by the federal government was borrowed!

As always, should you have any questions or concerns regarding your tax situation please feel free to call.

*This newsletter provides business, financial, and tax information to clients and friends of our firm. This general information should not be acted upon without first determining its application to your specific situation. For further details on any article, please contact us.*