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Lifetime Paradigm, Inc.
The Smart Tax Planning Newsletter

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Self-Employed with No Employees? Get Your COVID-19 Cash Now

Get ready for this: "I'm from the government, and I'm here to help."

Here's the deal: "I'm going to give you $20,833 today. I want you to give me $5,448 no later than two years from now. You can keep the $15,385 difference, tax-free—no strings."

It's true. The lucky recipient could be you. To obtain the full $15,385 tax-free cash result in this deal (one of many COVID-19-related assistance programs), you must

- be self-employed,
- have no employees, and
- have self-employment net profits of $100,000 or more.

If you are self-employed, you have no employees, and your net profits are

- $75,000, you pocket $11,538, tax-free.
- $50,000, you pocket $7,692, tax-free.
- $25,000, you pocket $3,846, tax-free.

The results above come from the COVID-19 Payroll Protection Program (PPP). When you are a self-employed taxpayer with no employees, the PPP treats you as the one and only employee, and treats your net profits as your payroll.

Big Picture

Under the PPP, you go to your bank or another Small Business Association (SBA) bank or lender and obtain the PPP loan based on your 2019 net profits. It's a no-doc loan—super easy. No credit report, no nothing.

Do This Now

Two steps:

1. Read this letter.
2. Get your bank (or another bank) to accept your application.

Don’t Procrastinate

The SBA runs out of PPP money in a hurry. The second round of funding started a few days ago.

If you snooze, you lose. And then you’ll have to wait until round 3 of funding, should it take place. (We think it will.)

If you are self-employed, with no employees, you absolutely need to qualify for this loan and its forgiveness. Think free money. Think cash help during this crisis.

Here are three questions and answers that will help you understand this program during these COVID-19 times. Read on.

Q&A 1

Question 1. I have income from self-employment, have no W-2 employees, and file a Form 1040, Schedule C. Am I eligible for a PPP loan?

Answer 1. You are eligible for a PPP loan if

- you were in operation on February 15, 2020;
- you are an individual with self-employment income (such as an independent contractor or a sole proprietor);
- your principal place of residence is in the United States; and
- you have filed or will file a Form 1040 Schedule C for 2019.

Q&A 2

Question 2. Since I have no employees, how do I calculate the maximum amount I can borrow, and what documentation is required?

Answer 2. Follow the three steps listed below:

1. Find your 2019 IRS Form 1040 Schedule C line 31 net profit. (If you have not yet filed your 2019 tax return, don’t fret. Fill out the Schedule C now. You need it for the loan.) If the net profit amount is over $100,000, reduce it to $100,000.
2. Calculate the average monthly net profit amount (divide the net profit by 12).
3. Multiply the average monthly net profit amount by 2.5.

Q&A 3

Question 3. What amount of the loan qualifies for forgiveness (remember, I don’t have any employees)?

Answer 3. You are going to like this. With no employees, your loan forgiveness is

- eight weeks’ worth (8/52) of your 2019 net profit (yes, last year, from that Schedule C you used for the loan amount—you don’t have to consider your 2020 profits);
- mortgage interest paid during the covered period (eight weeks from loan receipt) on real or personal business property (the interest you will deduct on Schedule C);

- rent payments during the covered period on lease agreements in force before February 15, 2020, to the extent they are deductible on Form 1040 Schedule C (business rent payments); and

- utility payments under service agreements dated before February 15, 2020, to the extent they are deductible on Form 1040 Schedule C (business utility payments).

The SBA will reduce your loan forgiveness by any COVID-19 qualified sick or family leave tax credit you claimed. Your loan is for two years, but you don't have to wait much longer than the eight weeks to apply for forgiveness. There are no prepayment penalties.

Example

Loan amount. Say your Schedule C shows $120,000 of net profit. Your limit is $100,000. Divide that by 12, and your monthly amount is $8,333. Multiply that by 2.5, and your loan amount is $20,833.

Loan forgiveness. Your loan forgiveness is $15,385 (8/52 of $100,000) plus qualifying interest, rent, and utilities, not to exceed total loan forgiveness of more than $20,513.

In the SBA loan application, the amounts from this example show as follows:

- Average monthly payroll: $8,333

- x 2.5 = $20,833

- Number of employees: self

Paperwork

The paperwork is easy:

- Your 2019 1040 Schedule C (if you have not filed yet, complete Schedule C now)

- Proof that you were self-employed during 2019, such as a 2019 Form 1099-MISC, invoice, bank statement, or other book of record

- Proof that you were operating as a Schedule C business on or around February 15, 2020 (a 2020 invoice, bank statement, or book of record)

- Completed application with an SBA lender

Other Facts to Know

How can I request loan forgiveness?

You submit your forgiveness request to the lender that is servicing the loan. The lender must make a decision on the forgiveness within 60 days.

What is my interest rate?

1.00 percent fixed rate.

When do I need to start paying interest on my loan?

All payments are deferred for six months; however, interest will continue to accrue over this period.

When is my loan due?

In two years.

Can I pay my loan earlier than two years?

Yes. There are no prepayment penalties or fees.

Do I need to pledge any collateral for these loans?

No. No collateral is required.

Do I need to personally guarantee this loan?

No. There is no personal guarantee requirement.

Takeaways

It's true: the government is here to help your self-employed business during these difficult times, even when the only worker is you. The funds you receive and the minimum amount forgiven are automatic—based solely on your 2019 Schedule C net profit.

You need to move quickly. The government's newest (round 2) PPP funding will be used up in a matter of weeks.

Get in the game now. Even if you miss out on this round 2 of funding, having your application on file for a possible round 3 of funding would give you a head start.

COVID-19: Tax Benefits for S Corporation Owners

To help your small business, Congress created a lot of new tax-saving provisions due to the COVID-19 pandemic. Many of my clients own and operate S corporations and expect the tax law to treat them differently, as it does with their health insurance deduction.

Perhaps you, too, would like us to help clarify which of the COVID-19 tax benefits the S corporation owner can use to put cash in his or her pocket. Here's a list as of today.

Payroll Tax Deferral

You can defer payment of your S corporation's employer share of Social Security tax on federal tax deposits you would otherwise have to make during the period beginning March 27, 2020, and ending December 31, 2020.

Your S corporation's deferred Social Security taxes are due in two installments. You must pay 50 percent by December 31, 2021, and the other 50 percent by December 31, 2022. If you are an S corporation owner, the S corporation can defer the employer portion of Social Security tax on your salary just as it can on any other employee.

PPP Exception

If your S corporation receives a PPP loan and it obtains loan forgiveness, it does not qualify for the payroll tax deferral provision.

PPP exception loophole. The PPP loan forgiveness prohibition doesn't apply until your S corporation receives a decision from your lender on PPP loan forgiveness. Before that date, you can defer payroll taxes even if you apply for and receive a PPP loan.

Example 1. You operate as an S corporation and have three employees, including yourself. Your S corporation's April payroll is $10,000, including your W-2 salary or wages.

The employer Social Security tax on this payroll is $620. Your S corporation doesn't have to pay it with its federal tax deposit. Instead, it will pay $310 by December 31, 2021, and the other $310 by December 31, 2022.

Employee Retention Credit

Your S corporation gets a refundable payroll tax credit against the employer share of employment taxes equal to 50 percent of its wages paid to employees after March 12, 2020, and before January 1, 2021. But the law also states that "rules similar to the rules of sections 51(i)(1) and 280C(a) . . . shall apply."

Code Section 280C(a) states you can't deduct wage expenses equal to the employee retention credit you receive—no double dipping.

Code Section 51(i)(1) affects the S corporation shareholder by denying the employee retention credit for wages paid to the following family members of a 50-percent-or-more shareholder:

- A child or a descendant of a child
- A brother, sister, stepbrother, or stepsister
- The father or mother, or an ancestor of either
- A stepfather or stepmother
- A son or daughter of a brother or sister of the taxpayer
- A brother or sister of the father or mother of the taxpayer
- A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law

The provision does not prevent the S corporation owner from taking the employee retention credit on his or her wages, provided that the S corporation otherwise meets one of the following requirements:

- A government order fully or partially suspended your operations during a calendar quarter due to COVID-19.
- Your calendar-quarter gross receipts are less than 50 percent of gross receipts from the same quarter in the prior year.

PPP exception. If you receive a PPP loan, then you don't qualify for the employee retention credit.

Example 2. ABC Corporation is an S corporation with four equal owners who each own 25 percent. It has eight employees: the four owners and four children of the owners. A government order partially suspended the business operations. Because no shareholder has 50 percent or more ownership, the wages of all eight employees qualify for the employee retention credit.

Example 3. DEF Corporation is an S corporation that is 100 percent owned by a married couple. It has four employees: the two owners and two children of the owners. A government order partially suspended the business operations. Only the wages of the two owners qualify for the employee retention credit.

Tax-Free Disaster Payments

Congress allows your S corporation to make tax-deductible disaster-related payments to its employees, and those payments are tax-free to its employees. But as you likely know, S corporation owners usually can't take advantage of tax-free fringe benefits, and usually have to include their value as taxable income on their W-2.

We have good news about disaster-related payments: none of the guidance issued about these payments denies their favorable tax treatment to the S corporation shareholder. In addition, the IRS doesn't mention such payments in Publication 15-B, *Employer's Tax Guide to Fringe Benefits*.

But we have some bad news, too—there is no guidance explicitly allowing the S corporation owner to take advantage of the tax-free disaster-related payments.

If you choose to have your S corporation provide tax-free disaster-related payments to you, we recommend you implement a formal, written plan and keep excellent documentation—even though such steps are not required by the law.

Example 4. Your S corporation sets up a plan to give every employee a $500 payment to cover telework supplies and ongoing expenses during the COVID-19 pandemic. Your business is subject to a shutdown order, and all 12 of your employees, including you, must work remotely from home.

The $6,000 in payments your S corporation provides is tax-deductible to the corporation and tax-free to the employees, including the S corporation shareholder.

Takeaways

Many small-business owners, like you, operate out of an S corporation. And as you know, the tax law sometimes isn't kind to S corporation owners, because the law limits or eliminates tax breaks other business owners can take.

Luckily for you, S corporation owners get to benefit from most of the big COVID-19 tax benefits, including:

- Payroll tax deferral
- Employee retention credit
- Tax-free disaster-related payments

COVID-19 Crisis Creates Silver Lining for Roth IRA Conversions

For years, financial and tax advisors have lectured about the wonderfulness of Roth IRAs and why you should convert traditional IRAs into Roth accounts.

But, of course, you didn't get around to it. In hindsight, maybe that was a good thing. For many, the financial fallout from the COVID-19 crisis creates a once-in-a-lifetime opportunity to do Roth conversions at an affordable tax cost and also gain insurance against future tax rate increases.

Roth IRAs Have Two Big Tax Advantages

Advantage #1: Tax-Free Withdrawals

Unlike withdrawals from a traditional IRA, qualified Roth IRA withdrawals are federal-income-tax-free

and usually state-income-tax-free, too. What is a qualified withdrawal? In general, the tax-free qualified withdrawal is one taken after you meet *both* of the following requirements:

1. You had at least one Roth IRA open for over five years.

2. You reached age 59½, became disabled, or died.

To meet the five-year requirement, start the clock ticking on the first day of the tax year for which you make your initial contribution to any Roth account. That initial contribution can be a regular annual contribution, or it can be a contribution from converting a traditional IRA into a Roth account.

Example: Five-Year Rule.

You opened your first Roth IRA by making a regular annual contribution on April 15, 2017, for your 2016 tax year. The five-year clock started ticking on January 1, 2016 (the first day of your 2016 tax year), even though you did not actually make your initial Roth contribution until April 15, 2017.

You meet the five-year requirement on January 1, 2021. From that date forward, as long as you are age 59½ or older on the withdrawal date, you can take federal-income-tax-free Roth IRA withdrawals—including withdrawals from a new Roth IRA established with a 2020 conversion of a traditional IRA.

Advantage #2: Exemption from RMD Rules

Unlike with the traditional IRA, you as the original owner of the Roth account don't have to take annual required minimum distributions (RMDs) from the Roth account after reaching age 72. That's good, because RMDs taken from a traditional IRA are taxable.

Under those rules, if your surviving spouse is the sole account beneficiary of your Roth IRA, he or she can treat the inherited account as his or her own Roth IRA. That means your surviving spouse can leave the account untouched for as long as he or she lives.

If a non-spouse beneficiary inherits your Roth IRA, he or she can leave it untouched for at least 10 years. As long as an inherited Roth account is kept open, it can keep earning tax-free income and gains.

Silver Lining for Roth Conversions

A Roth conversion is treated as a taxable distribution from your traditional IRA because you're deemed to receive a payout from the traditional account with the money then going into the new Roth account.

So, doing a conversion will trigger a bigger federal income tax bill for the conversion year, and maybe a bigger state income tax bill, too. That said, right now might be the best time ever to convert a traditional IRA into a Roth IRA. Here are three reasons why.

1. Current tax rates are low thanks to the TCJA.

Today's federal income tax rates might be the lowest you'll see for the rest of your life. Thanks to the Tax Cuts and Jobs Act (TCJA), rates for 2018-2025 were reduced. The top rate was reduced from 39.6 percent in 2017 to 37 percent for 2018-2025.

But the rates that were in effect before the TCJA are scheduled to come back into play for 2026 and beyond. And rates could get jacked up much sooner than 2026, depending on politics and the need to

recover some of the trillions of dollars the federal government is dishing out in response to the COVID-19 pandemic.

Believing that rates will only go back to the 2017 levels in the aftermath of the COVID-19 mess might be way too optimistic.

2. Your tax rate this year might be lower due to your COVID-19 fallout.

You won't be alone if your 2020 income takes a hit from the COVID-19 crisis. If that happens, your marginal federal income tax rate for this year might be lower than what you expected just a short time ago—maybe way lower. A lower marginal rate translates into a lower tax bill if you convert your traditional IRA into a Roth account this year.

But watch out if you convert a traditional IRA with a large balance—say, several hundred thousand dollars or more. Such a conversion would trigger lots of extra taxable income, and you could wind up paying federal income tax at rates of 32, 35, and 37 percent on a big chunk of that extra income.

3. A lower IRA balance due to the stock market decline means a lower conversion tax bill.

Just a short time ago, the U.S. stock market averages were at all-time highs. Then the COVID-19 crisis happened, and the averages dropped big-time.

Depending on how the money in your traditional IRA was invested, your account might have taken a substantial hit. Nobody likes seeing their IRA balance go south, but a lower balance means a lower tax bill when (if) you convert your traditional IRA into a Roth account.

When the investments in your Roth account recover, you can eventually withdraw the increased account value in the form of federal-income-tax-free qualified Roth IRA withdrawals. If you leave your Roth IRA to your heirs, they can do the same thing.

In contrast, if you keep your account in traditional IRA status, any account value recovery and increase will be treated as high-taxed ordinary income when it is eventually withdrawn.

As mentioned earlier, the current maximum federal income tax rate is "only" 37 percent. What will it be five years from now? 39.6 percent? 45 percent? 50 percent? 55 percent? Nobody knows, but we would bet it won't be lower than 37 percent.

The Bottom Line

If you do a Roth conversion this year, you will be taxed at today's "low" rates on the extra income triggered by the conversion.

On the (far bigger) upside, you avoid the potential for higher future tax rates (maybe much higher) on all the post-conversion recovery and future income and gains that will accumulate in your new Roth account.

That's because qualified Roth withdrawals taken after age 59½ are totally federal-income-tax-free, as long as you've had at least one Roth account open for more than five years when withdrawals are taken.

If you leave your Roth IRA to an heir, he or she can take tax-free qualified withdrawals from the inherited account—as long as at least one of your Roth IRAs has been open for more than five years when withdrawals are taken.

Grab Some Quick Cash with the CARES Act's Five-Year NOL Carryback

For many years, thanks to the net operating loss (NOL) provisions, the tax code gave you quick cash in your pocket if you had an overall net loss in a tax year.

Unfortunately, starting in 2018, the TCJA took away your ability to get almost instant benefit from your NOL. Now, due to the COVID-19 pandemic, Congress temporarily restored your ability to get fast cash from your net operating losses—even losses incurred in prior years (2018 and 2019).

NOL Defined

You have an NOL when certain deductions exceed your gross income. An NOL generally occurs when you have a net business loss for the tax year.

Example. John has a Schedule C loss of $40,000 and $10,000 in wage income from a part-time job. John's NOL is $30,000.

COVID-19 Temporary NOL Rules

The CARES Act suspends the TCJA limitations on your NOLs for tax years beginning in 2018, 2019, and 2020, which means you can

- carry back your NOL five years and carry it forward indefinitely, and
- apply 100 percent of the loss.

You can also elect to waive the carryback and only carry forward the NOL.

Claiming Your Refund

The best way to claim a refund from an NOL carryback is to use the "tentative refund" procedures by filing either

- Form 1045, Application for Tentative Refund, or
- Form 1139, Corporation Application for Tentative Refund.

If you qualify to use these forms to claim your refund, you get two benefits:

1. The IRS makes only a limited examination of the claim for omissions and computational errors.
2. You receive your cash refund within 90 days of filing your application.

Normally, to qualify to use this procedure, you'd need to file your application no later than 12 months after the end of the tax year in which your NOL arose. Therefore, for NOLs on a 2018 Form 1040, you'd normally be out of luck, as the deadline was December 31, 2019.

But the IRS has given you mercy: you have a six-month extension to file your Form 1045 or Form 1139 if you have an NOL that arose in a tax year starting in 2018 and that ended on or before June 30, 2019. For example, if your NOL was on your 2018 Form 1040, you now have until June 30, 2020, to file Form 1045.

CARES Act Fixes TCJA Glitch on QIP, Requires Action

Congress made an error in the TCJA that limited your ability to fully expense your qualified improvement property (QIP).

The CARES Act fixed the issue retroactively to tax year 2018.

If you have such property in your prior filed 2018 or 2019 tax returns, you likely have no choice but to correct those returns. But the bright side is that the corrected law gives you options that enable you to pick the best tax result.

What Is QIP?

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.

The CARES Act correction added the “made by the taxpayer” requirement to the definition.

QIP does not include any improvement for which the expenditure is attributable to

- the enlargement of the building,
- any elevator or escalator, or
- the internal structural framework of the building.

QIP Problem

Due to a TCJA drafting error in the law, Congress made QIP 39-year property for depreciation purposes and ineligible for bonus depreciation.

Unusual twist. This drafting error did not affect expensing under Section 179. Under the TCJA, you could have elected to expense some or all of your QIP with Section 179.

But now you have to revisit your previously filed 2018 and 2019 tax returns and consider 100 percent bonus depreciation, 15-year depreciation, and Section 179 expensing.

QIP Solution

The CARES Act made QIP 15-year property and made it eligible for bonus depreciation retroactively as if Congress had included it in the TCJA when it originally became law.

This change requires you to take a one-time, lump-sum bonus depreciation deduction for the entire cost of your QIP in the tax year during which you place the QIP in service, unless you elect out.

If the QIP lump-sum deduction creates an NOL, you can carry back that loss to get almost immediate cash.