

Benefit Big from the Work Opportunity Tax Credit

The Work Opportunity Tax Credit rewards your good deeds. And now, because of new legislation, the rules are in place for longer than usual. If you need to hire workers in your business, this dollar-for-dollar reducer of your taxes is one to know about.

Suppose your business hires a member of a targeted group. In that case, you can claim the potentially lucrative federal Work Opportunity Tax Credit (WOTC) for some of the wages paid to the individual.

Overview of the Credit

The credit generally equals 40 percent of *qualified first-year wages* paid to an *eligible employee*, up to a maximum wage amount of \$6,000. That translates into a maximum credit of \$2,400 (40 percent x \$6,000).

Of course, some employees don't work out. The tax code recognizes that and reduces the credit rate to 25 percent of qualified first-year wages for an employee who completes at least 120 but fewer than

400 hours of service. That translates into a maximum credit of \$1,500 (25 percent x \$6,000).

Eligible Employees

To be an eligible employee, your new hire must be certified as a member of a targeted group by the applicable State Workforce Agency (SWA). You, as the employer, can either

- obtain the certification by the day the employee begins work, or
- complete a pre-screening notice, using IRS Form 8850 (Pre-Screening Notice and Certification Request for the Work Opportunity Credit), by the day you offer a job to a prospective employee. Then submit Form 8850 to the SWA (not to the IRS) within 28 days after the employee begins work.

[Click here](#) for links to the names, addresses, phone and fax numbers, and email addresses of the WOTC coordinators for each of the SWAs.

A simplified certification process is available for qualified unemployed veterans.

You can claim the WOTC only if you hire a member of a targeted group. Targeted groups include the following:

- Qualified IV-A recipients
- Qualified veterans
- Qualified ex-felons
- Designated community residents
- Vocational rehabilitation referrals
- Qualified summer youth employees
- Qualified supplemental nutrition assistance benefits recipients
- Qualified SSI recipients (anyone who is certified by the designated local agency as receiving Supplemental Security Income benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date)
- Long-term family assistance recipients
- Qualified long-term unemployment recipients

Exceptions to the General Rule on Credits

There's a higher limit of \$12,000 for first-year wages paid to a qualified veteran who is entitled to compensation for a service-connected disability and was discharged or released from the military within

the past year. That translates into a maximum credit of \$4,800 (40 percent x \$12,000).

There's an even higher limit of \$14,000 for first-year wages paid to a qualified veteran who was unemployed for at least six months in the prior year. That translates into a maximum credit of \$5,600 (40 percent x \$14,000).

If a qualified veteran both has a service-connected disability and was unemployed for at least six months in the prior year, the limit for first-year wages is \$24,000. That translates into a maximum credit of \$9,600 (40 percent x \$24,000). Wow!

The WOTC for a long-term family assistance recipient equals 40 percent of qualified first-year wages, up to a maximum wage amount of \$10,000. That translates into a maximum credit of \$4,000 (40 percent x \$10,000).

In addition, for long-term family assistance recipients, the WOTC can be claimed for 50 percent of qualified second-year wages, up to a maximum wage amount of \$10,000. That translates into a maximum second-year credit of \$5,000 (50 percent x \$10,000) and a maximum combined credit for the two years of \$9,000 (\$4,000 + \$5,000). Another wow!

The WOTC for a qualified summer youth employee (a 16-year-old or 17-year-old who lives in an empowerment zone) equals 40 percent of first-year wages paid during any 90-day period between May 1 and September 15, up to a maximum wage amount of \$3,000. That translates into a maximum credit of \$1,200 (40 percent x \$3,000).

Tax Planning for the New \$142,800 Base for Self-Employment Taxes

What happens when lawmakers enact a new tax? It starts small. It looks easy.

In 1935, the self-employment tax topped out at \$60. Those 1935 lawmakers must be twirling in their graves with the new rules for 2021, which levy the following taxes:

- A self-employment tax of up to \$21,848, which comes from the 15.3 percent rate that applies to self-employment income of up to \$142,800.
- A 2.9 percent tax that applies to all self-employment income in excess of the base amount.

Beware

Look at what has happened to self-employment taxes since they first came into being in 1935, assuming you earn at the base amount:

- \$60 in 1935
- \$60 in 1949
- \$3,175 in 1980
- \$7,849 in 1990
- \$14,413 in 2006
- \$21,848 in 2021

To put the rates in perspective, say you are single and earn \$150,000. On the last dollar you earned—dollar number 150,000—how much federal tax did you pay? The answer in round numbers—39 cents (14 cents in self-employment and 24 cents in federal income taxes).

Wow! That's a lot. Then, if you live in a state with an income tax, add the state income tax on top of that.

Tax Planning

Two things to know about tax planning:

1. Your new deductions give you benefits starting at your highest tax rates.
2. In most cases, the return on your planning is not a one-time event. Once your plan is in place, you reap the benefits year after year. Thus, good tax planning is like an annuity.

Checklist

Here is a short checklist of some tax-planning ideas. Review these ideas so you can identify new business deductions for your tax return. You want business deductions because business deductions reduce both your income and your self-employment taxes.

- **Eliminate the word “friend” from your vocabulary.** From now on, these people are sources of business, so start talking business and asking for referrals over meals and beverages.
- **Hire your children.** This creates tax deductions for you, and it creates non-taxable or very low taxed income for the children. Also, wages paid by parents to children are exempt from payroll taxes.
- Learn how to **combine business and personal trips** so that the personal side of your trip becomes part of your business

deduction under the travel rules (for example, traveling by cruise ship to a convention on St. Thomas).

- Properly **classify business expansion expenses as immediate tax deductions** rather than depreciable, amortizable, or (ouch!) non-deductible capital costs.
- Properly **identify deductible start-up expenses** (\$5,000 up front and the balance amortized) rather than letting them fall by the wayside (a common oversight).
- Correctly **classify business meals that qualify for the 100 percent deduction** rather than the 50 percent deduction.
- Know the entertainment facility rules so your **vacation home can become a tax deduction**.
- Identify the **vehicle deduction method that gives you the best deductions** (choosing between the IRS mileage method and the actual expense method).
- Correctly identify your **maximum business miles**, so you deduct the largest possible percentage of your vehicles.
- Qualify your **office in your home as an administrative office**.
- Use allocation methods that **make your home-office deductions larger**.
- If you are married with no employees, **hire your spouse and install a Section 105 medical plan** to move your medical deductions to Schedule C for maximum benefits.

- Operate as a one-person **S corporation to save self-employment taxes**.
- If you are single with no employees, **operate as a C corporation and install a Section 105 medical plan** so you can deduct all your medical expenses.

IRS Focuses on Cryptocurrency

Cryptocurrencies have gone mainstream.

For example, you can use bitcoin to buy far more than you would think. To see, try googling “What can I buy with bitcoin?” You will get more than 350,000 hits. But using cryptocurrencies has federal income tax implications that may surprise you.

With the price of bitcoin having gone through the roof (before its recent decline), and with increasing acceptance of bitcoin and other cryptocurrencies as forms of payment, the tax implications of using cryptocurrencies are a hot-button issue for the IRS.

The 2020 version of IRS Form 1040 (the form you recently filed or will file soon) asks whether you received, sold, sent, exchanged, or otherwise acquired—at any time during the year—any financial interest in any virtual currency. If you did, you are supposed to check the “Yes” box.

The fact that this question appears on page 1 of Form 1040, right below the lines for supplying taxpayer information such as your name and address, indicates that the IRS is getting serious about enforcing compliance with the applicable tax rules. Fair warning!

The 2020 Form 1040 instructions clarify that virtual currency transactions for which you should check the “Yes” box include but are not limited to

1. the receipt or transfer of virtual currency for free (i.e., without having to pay),
2. the exchange of virtual currency for goods or services,
3. the sale of virtual currency,
4. the exchange of virtual currency for other property, and
5. the disposition of a financial interest in virtual currency.

To arrive at the federal income tax results of a cryptocurrency transaction, the first step is to calculate the fair market value (FMV), measured in U.S. dollars, of the cryptocurrency on the date you receive it and on the date you use it to pay for something.

When you exchange cryptocurrency for other property, including U.S. dollars, a different cryptocurrency, services, or whatever, you must recognize taxable gain or loss just as you do when you make a stock sale in your taxable brokerage account.

- You'll have a taxable gain if the FMV of what you receive exceeds your basis in the cryptocurrency that you exchanged.
- You'll have a taxable loss if the FMV of what you receive is less than your basis in the cryptocurrency.

It is hard to imagine that a cryptocurrency holding will be classified for federal income tax purposes as anything other than a capital asset—even if you use it to conduct business or personal transactions, as opposed to holding it for investment. Therefore, the taxable gain or loss from exchanging a cryptocurrency will be a short-term capital gain or

loss or a long-term capital gain or loss, depending on how long you held the cryptocurrency before using it in a transaction.

Example. You use one bitcoin to buy tax-deductible supplies for your booming sole proprietorship business. On the date of the purchase, bitcoins are worth \$55,000 each. So, you have a business deduction of \$55,000.

But there's another piece to this transaction: the tax gain or loss from holding the bitcoin and then spending it.

Say you bought the bitcoin in January of this year for only \$31,000. You have a \$24,000 taxable gain from appreciation in the value of the bitcoin (\$55,000 - \$31,000). The \$24,000 gain is a short-term capital gain because you did not hold the bitcoin for more than one year.

Detailed records are essential for compliance. Your records should include

- the date when you received the cryptocurrency,
- its FMV on the date of receipt,
- the FMV on the date you exchanged it (for U.S. dollars or whatever),
- the cryptocurrency trading exchange that you used to determine FMV, and
- your purpose for holding the currency (business, investment, or personal use).

Congress Closes the PayPal 1099-K Reporting Loophole

The PayPal loophole is going away in a little over six months from now.

You used to be able to avoid giving 1099s to contractors and vendors when you use PayPal or a similar service as your payment platform. This pushed the reporting requirements to PayPal. Current federal law requires that PayPal file Form 1099-K with the IRS and send it to you when

- your gross earnings are more than \$20,000, and
- you have more than 200 transactions.

Example. You work as a consultant. Your clients pay you \$30,000 via PayPal. PayPal does not give you a 1099-K because this fails the more than 200 transactions in a calendar year test.

According to lawmakers, this created a situation where those people who use PayPal have an easy ability to cheat (i.e., not report the income on their tax returns).

Starting January 1, 2022, the American Rescue Plan Act kills the two-step “more than \$20,000 and more than 200 transactions” threshold for third-party settlement organization (TPSO) filing of 1099-K and replaces it with the single “\$600 or more” reporting threshold.

The Joint Committee on Taxation estimates that this change in the 1099 rules will gain more than \$8 billion in new taxes over the next 10 years.

Several states have already closed this reporting loophole on the state level:

- Maryland, Massachusetts, Mississippi, Vermont, and Virginia require a 1099-K to be filed with the state tax agency if a TPSO pays a state resident \$600 or more during the year.
- Illinois and New Jersey have a \$1,000 1099-K threshold (plus, for Illinois, a requirement of at least four transactions).
- Arkansas has a \$2,500 threshold.
- Missouri has a \$1,200 threshold.