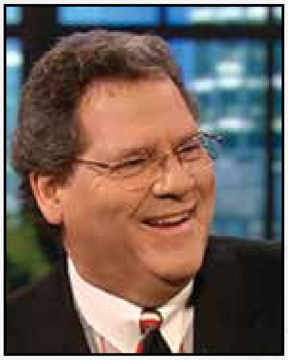

PILLA TALKS TAXES

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN

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End of Year Tax Planning

Nine Simple Steps That Can Cut Taxes And Pain

With the end of the year fast approaching, you're probably wondering what you can do to cut your taxes. Remember: if you wait until April to start thinking about this, it's just too late. Here are some ideas to get you moving in the right direction now

1. Consider paying state income taxes before December 31. Many people wait until April 15 to pay their state income taxes, since that's when they file their state tax returns. However, if you pay your state income taxes in 2023, you can't claim the deduction for those taxes until you file your 2023 tax return. That doesn't happen until April 2024. Thus, you have to wait an entire year before getting the tax benefit of the expense.

By paying your state taxes now, you get a deduction for those taxes in 2022. That means you get the benefit of the expense more than one year sooner than you'd otherwise realize.

Keep in mind, however, that the standard deduction for 2022 is double what it was prior to the Tax Cuts and Jobs Act. That means you may get a larger tax benefit by not itemizing, depending on your situation. It is also true that there is a $10,000 cap on what you can deduct for state and local taxes in 2022. Thus, if you are already at the cap for 2022, it won't help to pay more state taxes this year. You have to look at your situation carefully.

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2. Review your wage withholding or estimated payments. About 85% of all taxpayers get a tax refund when they file their tax returns. The average refund in 2022 was about $3,500. If you get a tax refund, it doesn't mean the government got religion and decided to give you free money. It means you paid more taxes than you owe. If you got a refund in 2022, you need to examine your withholding situation going into 2023 to make sure you don't overpay.

Whether you're an employee or you make quarterly estimated tax payments as a self-employed person, sit down now and do some preliminary calculations on your tax liability. Figure out if you overpaid. If so, consider adjusting Form W-4 (for wage earners) or your estimated tax payment pattern (for self-employed people).

Keep in mind that no law requires you to pay more taxes than you owe. For withholding purposes, you avoid under-withholding penalties if you pay either 100% of last year's tax (2021) or 90% of this year's tax (2022), whichever is *less*. Use that yardstick to guide you in adjusting your withholding going forward.

3. Count your money now. Each year, millions of people are blindsided come April 15 with surprise tax liabilities they can't pay. Don't wait until March or April to start figuring your tax, especially if 2022 was a particularly good year for you.

On the other hand, the Jobs Act cut taxes for about 80% of all taxpayers. And if you own a small business such as a sole proprietorship or S corporation, you get the benefit of the 20% deduction under §199A. That reduced taxes considerably for most small business owners.

It is important to sit down now and examine your 2022 financial situation. Substantial changes to your economic condition may increase your tax burden. If you don't have the money to cover the tax, you'll wind up as one of the 3-plus million taxpayers facing enforced tax collection actions.

Make sure you have a good handle on what you're going to owe. If you figure it out now, you have four and a half months to put together a plan to pay the tax. If you don't, you could be hit over the head in April. In my experience, it's that kind of shock that causes people to start making critical mistakes in how they handle their tax burdens. Often, it leads to years of hassle and harassment from the IRS.

4. Review your financial portfolio. One of the biggest problems with our tax system is the unfair treatment it inflicts on investment gains and losses. If you win with your investment, the IRS stands next to you with its hand out to get "its share" of your success. If you lose, you are, for the most part, standing alone.

The reason is that capital gains are subject to tax in their entirety in the year realized. However, capital losses are subject to a $3,000 deduction cap in a given year. That means if you lose $15,000 in an investment, you can only deduct $3,000 at time. This means it will take you five years to fully write off your loss.

This is true unless you have *both* capital gains and capital losses *in the same year*. If that's that case, you offset gains against losses, plus you can take an extra $3,000 of loss. Suppose you have $10,000 of capital gains and $12,000 of losses. In that case, the first $10,000 of losses offset against the gains. Then, you get the additional $2,000 of losses as a deduction that can offset other income.

In order to best utilize this rule, consider selling investments that are down in 2022 so you can offset that loss against any investments that made money during 2022. This allows you to effectively increase the allowable capital loss deduction, thereby recovering your losses much faster than you otherwise would. You should talk with your investment advisor regarding this strategy.

Also keep in mind that gain on crypto currency trades is fully taxable. This is true whether it is capital gain measured by the purchase/sale price of the crypto, or whether you were paid for goods or services with some kind of crypto currency. For more details on this, see my article in the October-November issue of *PTT*, in which I address the two key mistakes people make in addressing the taxability of crypto transactions.

5. Consider making equipment purchases. If you own a small business, now is the time to consider purchasing any equipment you might need for your business. A special tax code section creates an advantage for acting now.

Code §179 allows you to claim a full deduction for the cost of business tools and equipment placed in service in the year in question. Ordinarily, the cost of such equipment must be depreciated over its useful life. For example, if you purchase a copier for $5,000, you would normally have to depreciate that copier over three years. In that case, you get a deduction of $1,667 for each of three years.

But under § 179, you can fully expense up to $1,080,000 of equipment placed in service in 2022. This allows you to get the full benefit of the deduction in the year of the purchase, rather than having to spread the recovery over several years.

In years past, the deduction has bounced up and down, and even was on the verge of expiring on numerous occasions. However, the Jobs Act's benefits to businesses included a huge bump for the purchase business tools and equipment.

Take advantage of this deduction in 2022 if your income was unusually high this year. The best way to offset that income for tax purposes but still get the benefit of the money is to buy equipment you need to more effectively operate your business.

6. Fund a Medical Savings or Health Savings Account. One of the best-kept secrets in tax planning remains the Medical Savings or Health Savings Account. These accounts allow you to set aside money that is earmarked to pay medical expenses not covered by insurance (other than the insurance policy itself). By placing the money in a specially designated savings account, contributions to the account are tax deductible, up to certain limits.

It works much like an IRA or 401(k), except that you don't have to pay taxes on the money when it's distributed, provided you use it for medical expenses not covered by insurance. You can fund this account right up to December 31, 2022, and get a deduction for the money you put in, even if it's not used for medical expenses in 2022. What's more, any money left in the account at the end of the year carries over to 2023 and remains in your account, under your control. You don't lose the money. It's always available to you.

Be careful with this, however, because there are a number of complicated rules that apply. First, you must not be covered by any other health plan, including Medicare, in order to qualify. Next, your own insurance must be considered a high deductible health plan. The limits to what you can deduct are based on family size the health insurance plan itself. You most definitely need to consult with a health insurance specialist to see if this plan will work for you.

7. Fund a retirement account. An IRA, 401(k) or other retirement account can be funded anytime during 2022, and you'll get a deduction for the contribution (within limits) in 2022. In fact, for most retirement accounts, you have up to April 15 of the following year to contribute. You can get a deduction for the prior year simply by designating the contribution to apply to the prior year. That means a contribution made in 2023 can still apply to and be deductible in 2022.

8. Consider restructuring your business. There are millions of people operating small businesses in the form of sole proprietorships. And while this is probably the best way to start a new business, it may not be the best way to continue an existing business into the future. There are eight different forms of business

entities available, including a small business corporation or partnership. Depending upon the nature of your business and other non-tax considerations, one or more of the available entities might be a better idea than continuing as a sole proprietorship. January 1 is generally the most convenient time to change the structure of an existing business.

But first you need to understand which entity is best for you. I have an entire chapter in my book, ***Dan Pilla's Small Business Tax Guide***, to address this question. For the first time, business owners have a comprehensive guide to how each business entity works, and the pros and cons of each. If you are a small business owner, don't go another day without reading this material.

9. Catch up on your charitable contributions. If you make it a practice to give generously, consider making another contribution before December 31. This gives you further opportunity to cut taxable income and help those in need around you at the same time.

When making significant charitable contributions, note that you must have a contemporaneous acknowledgement from the donee organization if your contribution is for $250 or more. This applies to one-time contributions, not a total of contributions to a given organization over the span of one year. If you don't have the proper acknowledgement in hand by the time you file your tax return, the deduction is not allowed, even if you have your canceled check and even you get the statement later. That's why they call it a "contemporaneous acknowledgement."

HOW TO GET MORE HELP

If you need more help with end-of-the-year tax planning, consult one of the professional members of my Taxpayer Defense Institute (formerly Tax Freedom Institute). A list of the current consulting members is provided here.

Don't wait to take this action. If you do, you'll lose most of your opportunity to cut your taxes for 2019.

Taxpayers Defense Institute Consulting Members

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James Chase	Attorney	AL, GA (Pensacola FL)	(850) 434-3601	jchase@chaseattorneys.com
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Donald MacPherson	Attorney	S California	800-BEAT IRS	mac@beatirs.com
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Darrin Mish	Attorney	FL (Tampa)	(813) 229-7100	dmishesq@getirshelp.com
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Charles Markham	Enrolled Agent	MA (Norwell)	(781) 659-6600	charles@markhamandcompany.com
Manuel Mendoza	Enrolled Agent	MD (Bethesda)	(301) 962-1700	mendoza@mendozaco.com
Daniel J Pilla	EA, US Tax Court	MN (Stillwater)	(800) 553-6458	support@taxhelponline.com
Chris Churchwell	CPA	MO (Joplin)	(417) 781-1829	chris@chtaxgroup.com
Tom Zeiders	Attorney	OK, Tulsa	(918) 743-2000	tom@tax-amnesty.com
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Dionne Cheshier	Enrolled Agent	TX (Dallas)	(972) 514-1424	dionne@cheshiertaxresolution.com
Frank Rooney	Attorney	VA (Arlington), MD & DC	(703) 527-2660	rooneyf@irsequalizer.com

Does "Reasonable Cause" Apply to the Trust Fund Recovery Penalty?

The Burden of Proof is High

The Trust Fund Recovery (TFRP) penalty under code § 6672 hits corporate officers and employees who are: (1) responsible to withhold federal employment taxes from employees, (2) account for that withholding, and (3) pay it in full to the IRS, but who fail to do so. If the company fails to do any of those things, and the tax becomes uncollectible from the corporation itself, the IRS may assess an amount equal to the trust taxes (the tax withheld from workers' wages) against the corporate officers responsible for the failure.

THE NATURE OF THE TFRP

This penalty is not a "failure to pay" penalty the in the truest sense. Section 6651(b) provides for a penalty of up to 50 percent of the tax if the tax is not paid in full and on time. This is a delinquency penalty that applies unless the failure to pay is attributable to some reasonable cause factor, and one acted in good faith in connection with the tax responsibilities. In this sense, the penalty does not apply if one did not deliberately disregard IRS rules and regulations, but rather, the failure is attributable to unforeseen circumstances beyond one's control.

Does this good faith/reasonable cause defense apply to the TFRP? After all, it's a penalty, and penalties don't apply when unforeseen circumstances prevented compliance. Suppose a corporation has a large production contract with a third-party company, the fulfillment of which required the corp to hire a dozen additional workers. Now suppose the third-party company fails to pay under the terms of the contract, leaving the corp unable to pay its bills, including employment taxes.

Is that not reasonable cause for failure to pay the trust taxes? Would not those facts bear strongly in favor of relieving the corporate officers from the TFRP?

The TFRP is not a punitive penalty imposed (in addition to the tax) for failure to pay. The TFRP is a tax collection tool used by the IRS to make company fiduciaries (the "responsible officers") liable for the trust taxes that were not paid by the company. So let's distinguish between the unpaid employment taxes (the trust funds) and the delinquency penalty under § 6651. The latter is subject to reasonable cause abatement, but the former generally is not, because it is not a "penalty" for failure to act the strictest sense. The TFRP is a scheme that enables the IRS to pierce the veil of corporate protection and impose the company's liability upon its officers or employees who otherwise would not be subject to personal liability for corporate debts.

TFRP PENALTY AND "WILLFULNESS"

Section 6672 requires that in order to impose the TFRP penalty, the corp's responsible officers must have acted "willfully" in connection with the failure to pay. Willfulness implies deliberate intent, or intentional actions (or failures to act). It is generally distinguished from mistake, inadvertence, or other good faith reasons for the failure. In our example above, why wouldn't those facts vitiate the idea of willfulness?

They might. But the problem is the manner in which the courts have defined "willfulness" for the purposes of the TFRP. The courts universally declare (as shown below) that "willfulness" is found where a responsible officer makes a conscience decision to pay other creditors at a time when that person knows the federal taxes were unpaid.

For example, suppose in June 2022, the corp is unable to full pay $10,000 its employment taxes. In July 2022, the corp's responsible officers make the decision to pay its rent and suppliers, but not the taxes. After all, if these bills aren't paid, the company will fold quickly.

This choice to pay other creditors at a time when the taxes were delinquent is sufficient to establish "willfulness" on the part of the decision maker(s). Hence, one or more of them can be held liable for the TFRP. For full details on the "willfulness" concept in the context of the TFRP, see chapter 8 of ***Dan Pilla's Small Business Tax Guide***, and chapter 6 of ***Taxpayers Defense Manual.***

CAN GOOD FAITH CANCEL WILLFULNESS?

If "willfulness" is the standard, why can't "reasonable cause" cancel willfulness? The answer is it can, but only in very narrow circumstances.

The Tenth, Eleventh, Second, and Fifth Circuits have determined that the "reasonable cause" defense may apply to willfulness determinations, but only when the responsible officer did not knowingly pay another creditor over the IRS. This is the key. Once the tax is owed to the government, any payment to a third party generally establishes willfulness, as long as the decision-maker knows that the tax is owed.

In *Smith v. United States*, 555 F.3d 1158, 1170-71 (10th Cir. 2009), the court held that the reasonable cause defense must be narrowly construed with respect to § 6672. The court stated:

> In *Finley v. United States*, 123 F.3d 1342, 1348 (10th Cir.1997) (en banc), we recognized the "reasonable cause exception" to "excuse the failure to pay" payroll taxes held in trust for the government. We further held that the reasonable cause exception to *§ 6672* liability should be "narrowly construed." *Id*. We then concluded that "reasonable cause sufficient to excuse a responsible person's failure to pay withholding taxes should be limited to those circumstances where (1) the taxpayer has made reasonable efforts to protect the trust funds, but (2) those efforts have been frustrated by circumstances outside the taxpayer's control." *Id*. In *Finley*, we remanded the case for a new trial to provide the taxpayer an opportunity to present his defense.
>
> The facts in *Finley* differed from those presented here. Under the facts in Finley, the taxpayer directed that the payroll taxes be paid, and by the time he found out his instruction had not been followed, there was no longer any money to pay them. Here, Smith knew the payroll taxes were overdue, knew that other creditors were being paid instead of the payroll taxes, and never took any direct action to pay the taxes. He discussed the payroll tax issue repeatedly with Mark Woodruff throughout 2002-03, but never actually attempted to pay the taxes. According to the evidence presented, he was even directly instructed in one instance to keep the taxes current. The reasonable cause exception to *§ 6672* liability does not fit the facts of this case.

Note the court's point that Smith knew the taxes were not being paid and that other creditors were being paid. This killed his reasonable cause argument.

In *Thosteson v. United States*, 331 F.3d 1294, 1301 (11th Cir. 2003), the Eleventh Circuit faced for the first time the question of whether a “reasonable cause” defense applies to the TFRP. “We decline,” it said, “however, to address this issue today. Such defense as applied by other circuits would still not be applicable under the facts of this case for the same reasons set forth by the Fifth Circuit in addressing a similar situation.”

The court then explained that, “No such defense may be asserted by a responsible person who knew that the withholding taxes were due, but who made a conscious decision to use corporate funds to pay creditors other than the government.” *Id*. Implicitly the court was adopting a test like that in *Smith*, and holding that it failed for this taxpayer.

In *United States v. Winter*, 196 F.3d 339, 345-46 (2nd Cir. 1999), the court focused on the question of knowledge. It held that the reasonable cause defense negates willfulness only if the responsible person reasonably believed the taxes were being paid.

> Even a responsible person may not be held personally liable under *§ 6672(a)* unless his or her failure to collect, account for, or remit withholding taxes was willful. *26 U.S.C. 6672(a)*. In order to satisfy the willfulness requirement, a responsible person need not act out of an evil motive or an intent to defraud. *Rem*, 38 F.3d at 643. Instead, “[t]he principal component of willfulness is knowledge: a responsible person acted willfully within the meaning of *6672(a)* if he (a) knew of the company’s obligation to pay withholding taxes, and (b) knew that company funds were being used for other purposes instead.” *Id*. Thus, failures are willful within the meaning of *§ 6672(a)* if they are “voluntary, conscious and intentional as opposed to accidental decisions not to remit funds properly withheld to the Government.” *Kalb v. United States*, 505 F.2d 506, 511 (2d Cir. 1974) (quoting *Monday v. United States*, 421 F.2d 1210, 1216 (7th Cir. 1970)). “Willful conduct may also include a ‘reckless disregard for obvious and known risks’ as well as a ‘failure to investigate . . . after having notice that withholding taxes have not been remitted to the Government.’” *United States v. Landau*, 155 F.3d 93, 101 (2d Cir. 1998) (quoting *Kalb*, 505 F.2d at 511).
>
> That said, this Circuit recognizes a so-called “reasonable cause” exception to § *6672(a)* liability: “[A] responsible person’s failure to cause the withholding taxes to be paid is not willful if he [or she] believed that the taxes were in fact being paid, so long as that belief was, in the circumstances, a reasonable one.” *Rem*, 38 F.3d at 643 (citing *Kalb*, 505 F.2d at 511). However, even if a responsible person did not know contemporaneously of the company’s nonpayment of withholding taxes, he or she will be held liable for any nonpayment if, when he or she became aware of the delinquency, the company had liquid assets with which to pay the overdue taxes. *Id*.

In *Logal v. United States*, 195 F.3d 229, 233 (5th Cir. 1999), the court denied the reasonable cause defense, but in doing so it outlined when the defense would work.

We have consistently held that the reasonable cause defense to a *6672* action is exceedingly limited. In *Bowen v. U.S.*, 836 F.2d 965, 968 (5th Cir. 1988), we stated that “[a]lthough we have recognized conceptually that a reasonable cause may militate against a finding of willfulness, no taxpayer has yet carried that pail up the hill.” *See also Newsome v. U.S.,* 431 F.2d 742, 747 (5th Cir. 1970). No such defense may be asserted by a responsible person who knew that the withholding taxes were due, but who made a conscious decision to use corporate funds to pay creditors other than the government. *Newsome*, 431 F.2d at 747 n. 11; *Frazier v. U.S.*, 304 F.2d 528, 530 (5th Cir. 1962). Here, Logal consciously decided to make payments to creditors other than the government even though he knew that the withholding taxes had not been paid. The facts Logal relied on were not sufficient to support a reasonable cause defense. Thus, the district court committed no error in refusing to instruct on this defense.

The conclusion is that "reasonable cause," though limited, can apply to a TFRP. The heavy burden on the citizen is to prove, either: (1) he did not know that the withholding taxes were due, or (2) did not make a conscious decision to use corporate funds to pay other creditors at a time when he knew money was owed to the government.

How You Can Ask Dan Pilla a Question

If you have questions or problems you'd like Dan Pilla to address, please write to Dan at:

215 W. Myrtle Street
Stillwater, MN 55082

or e-mail to:

expert@taxhelponline.com

Write the word "newsletter" in the subject line.

Did You Miss The 2022 Taxpayers Defense Conference?

Self-Study Material is Now Available

If you missed the 2022 Taxpayers Defense Conference, our self-study material is available. The set includes audio recordings of all the teaching sessions and all Dan's lecture notes and other hand-out material.

The 2022 Defense Conference theme is Tax Refunds. Topics for the 2022 Defense Conference include the following:

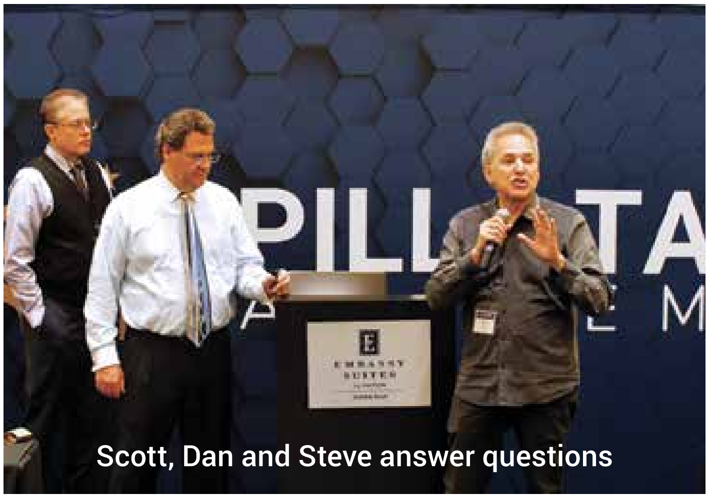
- An analysis of what to expect from the revitalized IRS
- Claim for refund law and procedures
- Addressing refund statute of limitations issues

Steve Klitzer teaches on IRS negotation tactics

- The 3-year rule and financial disability
- Employment tax refunds through the Employee Retention Credit
- 2 ethics sessions including negotiating with IRS personnal and understanding the rules

Scott MacPherson teachs his ethics session

Robert Cantu gives an analysis of the Inflation Reduction Act



Scott, Dan and Steve answer questions

regarding legal positions taken on tax returns and with IRS submissions

- And don't forget our live role-playing and group debriefing sessions
- Finally, as always, we have our popular and informative moderated discussion where all topics and problems are fair game.

The Taxpayers Defense Conference is widely regarded as simply the best tax seminar in the country—and for good reason. There is no place else you can go to get the up-to-date, cutting edge information you need to effectively represent your clients in problems resolution issues. And that's a fact.

If you missed the live seminar, don't delay in ordering your self-study course now. Get yours by calling the TFI/TDI office at 800-346-6829. Talk to Jean about getting both the 2021 and 2022 Defense Conference materials for self-study. This is the best CE seminar in the county.

TFI is an approved IRS CE provider. | **800-346-6829**

California's Laffer Curve

BY DAVID R. HENDERSON

Economist Arthur Laffer is justly famous for the Laffer Curve, which shows that if tax rates go high enough, tax revenues actually fall. There is no real controversy about whether the Laffer Curve exists. At a 0 percent tax rate, the government would collect zero revenue. As the tax rate rises above zero, the government would collect some revenue. At a 100 percent tax rate, people would earn zero reported income and the government would collect zero revenue. Voila: we've just proved the Laffer Curve.

The real controversy is about where we are on the Laffer Curve. Are federal tax rates so high that increasing tax rates would further reduce revenue? Probably not. But are they so high that raising them by x percent will increase tax revenues by substantially less than x percent? Probably.

The Laffer Curve issue is even more interesting at the state level. When the feds raise tax rates, you can't avoid them by moving to another state within the United States. But when a state government raises tax rates, residents of that state have 49 other states plus the District of Columbia as potential places to move to.

State governments, like the federal government, probably don't care much about most people; they don't have an incentive to care. But there is at least one thing they must care about: getting tax revenue. So if enough people respond to higher state tax rates by cutting back on work and investment or by moving, the state government won't raise nearly as much tax revenue as it expected.

This has happened in California. Joshua Rauh, an economist at Stanford University and a senior fellow with the Hoover Institution, has co-authored an important study of the effects on revenues of a major increase in marginal tax rates in California. In 2012, Californians voted to increase the top marginal tax rate from the then-high 9.3 percent to rates ranging from 10.3 percent to 12.3 percent. Add in the pre-existing 1-percentage-point extra tax on people making over $1 million a year, and you get rates ranging from 10.3 percent to 13.3 percent.

Rauh and co-author Ryan Shyu of Stanford's Graduate School of Business find that of the extra revenue the state government would have raised if high-income people had gone on with business as usual, 55.6 percent was lost over the first three years of the higher taxes. That was due to people leaving the state and to the high-income "stayers" making less income than otherwise in response to the higher tax rates. The effects were even larger in the last of the three years the economists studied. That makes sense because the longer the taxes were in force, the more time people had to adjust.

The Laffer Curve in California is alive and well. Which is more than can be said for California.

David R. Henderson, *a research fellow with the Hoover Institution at Stanford University.*

EDITOR'S NOTE: In session 11 of the 2022 Defense Conference, I did an impromptu analysis of tax policy in which I address the economic impact of increasing tax rates versus spreading the tax base. In that analysis, I explained the Laffer Curve and I drew an example of a Laffer Curve on the white board to illustrate exactly how this economic reality works. Check this out!