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Online Advisor – December 2021

Upcoming dates:

Nov 28 - Dec 6 - Hanukkah

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

To help celebrate this holiday season and momentarily forget about potential supply shortage frustrations you may encounter while shopping, this month's newsletter features a fun quiz about toy crazes from the past. This fun trip down memory lane is sure to be a crowd pleaser!

Also read about recent tax court cases that have great tax messages for all of us, five great money tips, and ideas to help your business prepare for surprise expenses.

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.

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



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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 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.



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- **A Slight Understatement.** (*Pragias, 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.

Holiday Quiz: These Hot Toys Created Shortages

How well do you know the holiday shortages of yesterday?

With all the talk around ports being clogged and transportation backups causing product shortages, why not take a look back at famous holiday shortages caused by the demand for the toy EVERYONE just had to have! So grab your family and friends, put away the cell phones, take out a piece of paper, and see who knows more about these true, historic shortages.

1. In 1983, this toy came with its own certificate of adoption, but only if you could find one.
2. This hand-held gadget created a bond that if broken could be fatal. At its peak they were selling 15 of them every minute!
3. In 2014, this supplier limited purchases of this toy to two dozen per person, but it sold out months before the holidays, with some selling on eBay for as much as \$1,000. Fortunately, the company making the toy was able to solve the supply problem in time for the holidays. Can you name it?



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4. For three years in a row, from 2005 thru 2007, game consoles were all the rage. Give yourself a point if you can name all three.

5. Red and popular, this toy was as scarce as ice in a campfire during 1996. But every small child just had to have one.

6. This hand-held puzzle was all the rage in 1981. Can you name it?

7. In 1998 these small creatures could be trained to speak English...that is if you could get one.

8. Often a TV program inspires scarcities in the toys it creates. This colorful group was tough to find in 1993. Never fear, the supplier geared up for the next season only to be out of stock once again in 1994. What is the name of this group of toys?

9. These little furballs were cute, cuddly and hard as ever to find in 2009. This \$9 toy often fetched up to \$60 each. Can you name them?

10. And last, but not least, this extremely popular toy in the 1950s may have started the holiday toy craze...mainly because it was advertised on television. But the toy required a food product from your pantry to make it come to life. What was it?

Answers: 1. Cabbage Patch Kids, 2. Tamagotchi, 3. Elsa doll from Disney's Frozen movie, 4. Xbox 360, PlayStation 3, and Nintendo Wii, 5. Tickle Me Elmo, 6. Rubik's Cube, 7. Furby, 8. Mighty Power Rangers, 9. ZhuZhu Pets, and 10. Mr. Potato Head

So how did you do?

0 – 2 right...No worries. Shortages don't seem to bother you.



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3 – 5 correct... You probably have asked for a couple of these.

6 – 8 correct... You are a cultural icon! Pat yourself on the back.

9 – 10 correct... You are a monster shopper.

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.
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.



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Surprise Bills: Prepare Your Business for the Unexpected

Getting a bill for an unexpected expense can put a significant dent in your business's cash flow. Here are some tips your business can use to deal with a surprise bill.

- **Stick to a reconciliation schedule.** The best advice is to be prepared for the unexpected. Do this by knowing how much cash you have in your bank account at any given time. This is done by sticking to a consistent bank reconciliation schedule. Conventional wisdom suggests reconciling your bank account with bills paid and revenue received once a month. But if your business doesn't have that many transactions, you could reconcile once every two or three months. No matter what time frame works for you, be consistent with your review!
- **Create a 12-month rolling forecast.** This exercise projects cash out twelve months. Then each new month you drop the prior month and add another month one year out. This type of a forecast will reflect the ebbs and flows of cash throughout the year and identify times that you'll need more cash so when a surprise bill shows up, you know exactly how it will impact your ability to pay it.
- **Build an emergency fund.** Getting surprised with an unexpected business expense isn't a matter of if it will happen, but when. Consider setting money aside each month into an emergency fund to be used only in case of a significant expense. A longer term goal could be to save enough money to cover 3 to 6 months of operating expenses.
- **Partner with a business advisor.** Even small businesses sometime need help keeping their cash flow in line and avoiding unexpected expenses. Please call if you have any questions about organizing your business's cash flow and preparing for surprise expenses.

Make Payroll Taxes Easy in 2022

Handling employment taxes can be complicated, especially when you're required to file important tax documents throughout the year. Here's a quick recap of the most vital payroll tax forms and what you can do to make your payroll life easier heading into 2022.

Important Payroll Tax Forms

- **Form 941 — Employer's quarterly federal tax return.** This form is used to report income tax withheld from employees' pay and both the employer's and employees' share of Social Security and Medicare taxes. Employers generally must deposit Form 941 payroll taxes on either a monthly or semiweekly deposit schedule.



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- **Form 940 — Employer's annual federal unemployment tax return (FUTA).** This return is due annually at the end of January. However, FUTA taxes must generally be deposited once a quarter if the accumulated tax exceeds \$500.
- **Form W-2 — Wage and tax statement.** Employers are required to send this document to each employee and the IRS at the end of the year. It reports employee annual wages and taxes withheld from paychecks.

Make payroll easier

- **Remind employees to review withholdings.** January is a great time to remind your employees to check their paycheck's tax withholding amounts. Various life events in the preceding 12 months can potentially lead to one of your employees owing a different amount of taxes in 2022 than they owed in 2021. And no matter how hard you try, employees will ask for your help. So get ahead of the curve with this simple review reminder.
- **Create a payroll forecast.** Be prepared for how much you'll spend on salaries and wages in 2022 by creating a payroll expense and benefit forecast. In addition to base salaries and wages, include the following in total salary and wage expenses: Your share of an employee's Social Security and Medicare taxes; health insurance premiums paid on behalf of employees; and any other benefits you provide to employees.
- **Ask for help.** Payroll compliance involves many moving parts at the local, state and federal levels. Please call if you have any questions about your business's payroll tax compliance, and how to properly account for payroll expenses on your financial statements.

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



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Inflow: \$3.464 trillion

Outflow: \$4.448 trillion

Deficit: \$984 billion

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



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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 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 ¼ of the money spent by the federal government was borrowed!
- **Low interest expense risk.** Look at the percentage of money spent on interest expense in 2019. It's 8% with interest rates hovering around zero. So what happens when rates actually start to go up? As a percentage of overall expenditures, interest expense could double to 16%...and potentially go even higher than that.
- **Make a difference.** Whether we should spend more or less is not the issue. It is that spending more than you bring in will cause big problems...eventually. Money doesn't just magically appear on printing presses. That money has to come from someplace and that someplace is from everyone. So make your voice heard...it's your money!

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

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