LOOKAHEAD ADVISORY PRESENTS

# DEBUNKING THE TOP 5 SOCIAL MEDIA TAX MYTHS

Learn about what to do, and what not to do, when it comes to popular social media tax strategies.

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# LLC'S = MORE TAX SAVINGS?

One of the more common misconceptions I see about taxes on social media is how forming an LLC if you have a business will create tax deductions that previously weren't. This is simply untrue.

The main thing to remember about LLCs is they they are a LEGAL designation, not a TAX designation. This is a formation you do with your state, it has nothing to do with the IRS. The IRS views single-member LLCs as "disregarded entities" for tax purposes, which means they are ignoring the fact that you're an LLC and treating all the income/expenses incurring in that business activity as if they're just happening to you personally. This is true whether you're running a business or have an single-member LLC that holds property. Now if it's a multi-member LLC (meaning more than one owner), congrats! You now have a partnership and have to file a form 1065 for your business activity.

The good news about single-member LLCs not being a tax designation, is that you will have just as many tax deductions available to you as if you had no LLC in place.

Now, a reason you might want an LLC is if you want a level of liability protection that separates you and your assets from your business. If you're unsure about whether this is necessary for your line of work, it would be beneficial to consult an attorney on this.

Another reason an LLC might be beneficial is if you have future plans to grow your business, hire employees, and eventually elect to be taxed as an S-Corporation or become a Partnership.

What will happen (as I found out with a client) is if you hire employees as a sole proprietor, then decide to become an LLC, you will have to start a completely new entity to move over your employees. As a sole proprietor, you cannot move your EIN to an LLC.

One downside as of 1/1/24 to filing as an LLC is the new BOI reporting requirement. This is a new requirement that requires state-formed business entities to report their ownership information to the federal government (this is not a public database) in an effort to curb money laundering and other financial crimes.

This is required to be filed when your entity is formed. If you had an LLC prior to 1/1/24, you must file this initial report by 1/1/25. If you're filing an LLC in 2024, you have 90 days to file the report, and 30 days to report changes in ownership. If you form an LLC after 1/1/25, you must file your initial report within 30 days of the entity formation, and 30 days to report changes in ownership. Fortunately, the filing can be completely done online at FinCEN's website. It's important though that these filings are done timely, otherwise monetary and potential criminal penalties can be enforced.

# CHAPTER 2

# THE AUGUSTA RULE

The Augusta Rule is a rule in the tax code that allows homeowners to rent out their personal residences up to 14 days per year without having to report the rental income on their taxes (they also can't deduct the allocable expenses as well). This tax strategy is promoted on social media and encourage sbusiness owners to "rent" their home to their business ofr events or meetings. In doing so, they secure a tax deduction for the business while avoiding personal income tax on the rental income.

The application of the Augusta Rule is not without its complexities and pitfalls, as evidenced multiple cases that have gone through the tax courts. In Sinopoli v. Commissioner, the taxpayers attempted to use the Augusta Rule by expensing substantial rental payments for holding monthly shareholder meetings in their homes over three years, totaling $290,000.

A key issue in the Sinopoli case was the taxpayers' inability to prove why they believed they were entitled to such high rental rates for their home. In order to utilize the Augusta Rule as a self-rental, you have to use a rental rate that's comparable to other rentals for your area. You can't rent your home to yourself for the same rates it would cost to stay at the Four Seasons, for example.
The IRS adjusted the deduction significantly downwards, allowing only $500 per meeting where business activities could be evidenced, reducing the total deduction from $290,000 to just $10,500 over three years. That's quite the adjustment.

There is a tax-influencer who sells this “tax strategy” for $10k and gives you a binder with templates in order to claim this “correctly”. You can go pay them $10k, or you can just read on and I’ll tell you what to do for free.

1. Have a business meeting that is of more than just YOU or family members. It’s going to be too big of a hurdle to prove economic substance (fancy way of saying legit business dealings) if you’re having a “meeting” at your house that’s comprised of all the same people that were there for Thanksgiving two months ago.
2. Don’t have a business home office that’s claimed on your return. To use the Augusta Rule, total rental days can only be 14 or less. If you have a home office you’re claiming, that’s techinically other rental activity and you’ve surpassed the 14 day rule.
3. Do research and **document and save** 3-5 different comparables that justifies your meeting rental rate. These could be places like hotel conference rooms, co-work spaces, event rental spaces, etc that are similar in size/amenities to your place.
4. Take and keep in your records meticulous notes of the event > the who/what/when/where and why of what went on. Part of what we see in tax court cases is Augusta Rule deductions being thrown out because the taxpayer couldn’t actually support what activities went on at the meetings. You need to provide a list of who was there, dates they were there, the times they were there, and an itinerary of what was done and discussed.
5. Once all that’s said and done, at the end of the year your company needs to issue a 1099-Misc to you personally for rents paid (efile4biz.com is an easy platform to do this with). Then on your personal return, you’ll need to report that 1099-Misc income on your schedule E, with a deduction for that same amount citing the Augusta Rule.

So, can this be a legitimate strategy for saving on taxes? Absolutely. But it needs to be done correctly and the steps above followed to a “T” in order to ensure your deduction is appropriate and substantiated.

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# HIRING YOUR KIDS

A tax strategy I see touted FAR too often on social media is hiring your kids. The logic is as follows - if you file as a Schedule C or Partnership (if both parents are partners), and hire your children (under 18), those wages are not subject to payroll taxes for either the employer or employee. Now if your children are hired under a S-Corp or C-Corp, their wages are subject to payroll taxes.

Their work-around if you have your business in a corporation and thus are subject to payroll taxes is to set up a "Family Management" (we'll call it FM for short) company on a Schedule C. They pay the FM a service fee from the corporation for the work the kids are providing (thus getting a deduction on the S-Corp or C-Corp side as an expense), then turnaround and pay the kid's salary out of the FM.

If the child's wages for the year are under the standard deduction ($14,600 for 2024), they will not owe federal taxes on that earned income (whether they owe at the state level will be state-by-state dependent). Then with that earned income, they can contribute to a Roth IRA and start saving for retirement.

There are multiple problems that we run into quickly when taxpayers are being coached to implement this tax strategy.

The first revolves around the work the child is being paid for as being "ordinary and necessary" for the course of business. A common example I see is hiring your children as "models" for promotions in your business, and turning around and paying them anywhere from 100s to 1000s for their "modeling servies".

But are advertisements of you children modeling ordinary and necessary to your business? How many other businesses in the same industry would have that same expense - the expense of paying child models to model in advertisements? I'm going to go out on a limb and say, not many for most industries. That means taking cute photos of my kids, slapping it on my accounting firm's website or car (yes I know a tax influencer who does that), and saying they've earned a wage for their modeling services provided to me, would not pass an audit.

The second revolves around suitability and age-appropriateness. Is the work being performed suitable for their age? I prepare tax returns, could I reasonably say that I'm paying my 8 year-old to help me with tax returns? Absolutely not. So any work they could feasibly do and a reasonable compensation for paying them, would be restricted by their age. I can't pay an 8 year-old $100/hr for cleaning my office once a week. It has to be the same rate I would hire someone of similar suitability to perform the work.

And at $15/hr (let's be real, it would be VERY difficult to substantiate why a child should be paid more than this), that's 81 hours of work a month to get them to a $14,600 wage per year. So that's 20 hours of work per week you'd need to justify in order to pass an audit.

When it comes to setting up FM companies to run the payroll through, we quickly run into issue of economic substance.

Basically, economic substance (which I mentioned in the Augusta section) means a transaction has to have a real business purpose outside of just obtaining a tax advantage. If the only purpose of the FM exists to pay your kids outside of your corporation in order to save on payroll taxes, that lacks economic substance. Better to just save yourself the trouble and if they're a legitimate employee, pay them directly from your respective company.

The tax court case of Alexander, Michael D., et ux. v. Commissioner is a checklist of exactly what NOT to do when hiring your kids. Things they did which caused the court to disallow the payments to the kids included:

- Not paying wages on a timely schedule (son worked in summer for business, but was getting paid all throughout the year)
- Payments to their daughters were not actually made in cash. Instead, a running total was kept and they "deducted" purchases from the total.
- Deciding a "flat" wage at the beginning of the year independent of what services were performed over what period of time
- No record of hours children actually worked
- Paying them for work that was actually household chores
- The taxpayers required things such as family trips to be paid from the running total mentioned above indicating these were payments for personal expenses and not true wages
- The amounts paid to the daughters HAPPENED to be the exact amount of the standard deduction that year ($4,250)
- No W-2's were issued for payments made

So in order to made this strategy audit-proof, you need to do the exact opposite of what's above:

- Enter into and sign a formal employer/employee agreement laying out pay and duties of job as you would with any other employee
- Follow applicable local, state and federal labor laws
- Pay a reasonable rate for the work performed and skill required to perform job
- Keep timesheets of days/hours worked and tasks performed
- File all required local, state and federal forms in a timely manner
- Make sure there is not work being performed that isn't 100% related to the business (eg no household chores)
- Remit payment via payroll in a timely manner in accordance to hours worked on a regular schedule as you would any other employee
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The real key here is - treat hiring your child as you would any other employee and document everything they do for you so you can substantiate what you're actually paying the to do.

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# THE G-WAGON DEDUCTION

I swear if I hear ONE more person telling people to buy a G-Wagon to save on taxes...

For 2024, there is currently a 60% Bonus Depreciation on work vehicles weighing over 6,000 lbs. From 2018-2022, this amount was 100%. For 2023 it was 80%, but there's currently legislation in the words as I write this that might retroactively bump it back up to 100% for 2023.

When it was 100%, every other video on my social media feeds were tax influencers telling people to buy G-Wagons to wipe out their taxable income, hence why I'm calling it the "G-Wagon Deduction".

Normally, depreciation on a vehicle is taken over 5 years, but Bonus Depreciation allows you to accelerate it and take more of it in earlier years. Thus if you had a high earning year and wanted to wipe out income to pay less in taxes, buying an expensive asset before year-end that you could completely write off is one way to do that. I'm not saying it's the smart way to do it, I'm just saying it's one way to do it.

There are a couple caveats to this particular write-off that you must keep in mind. First, you have to use the vehicle at least 50% of the time for business to even qualify to take this deduction. Then, you can only deduct the allocable portion of the vehicle you actually use for business. This is determined by miles driven from one work activity to another verse miles driven personally. If you're driving from your home to a worksite, that's not deductible use of the vehicle.

The one work-around to unlock more of a deduction is if you can establish a home-offce (where you do the majority of your business). Then any travel from your home to a worksite or event is now deductible. In order as well to support business use on a vehicle that isn’t 100% used for business, you must keep a mileage log of all business miles drivne.

*What if I put a logo on my car? Everytime I drive around it’s advertisement so can’t I write off the car?*

No. There’s a case (James William Avery v. Commissioner) where this exact scenario comes up. It involves an attorney attempting to write off his sports car because he has his business advertised on it as a “sponsor”. The courts disallowed it. In reality, you’re only able to deduct the cost for the advertisement placed on your car (eg the cost to wrap a car with your logo), but not any expenses of operating and maintaining the vehicle itself.

*What if I’m an influencer and have my sports car in the content I make?*

No. Again, this comes down to actual “business use” of the vehicle. Outside of it appearing in a 30 second video, do you use it for business? Or is the rest personal? Unless it’s sitting under a tarp in your garage for the rest of your life or appearing daily in videos you make specifically about the car, I’m going to assume there is some personal use going on there. Remember with the IRS, you are guilty until proven otherwise. The burden of proof will always be on you to justify your deductions.

The other part tax influencers fail to mention is - what happens when you sell the car? There's a little thing called "depreciation recapture" and you have to pay ordinary income tax on any prior depreciation taken.

Let's say you buy a $150k G-Wagon, qualify it for 66% business use and deduct $100k of it. When you go to sell the G-Wagon, the first $100k you sell it for you'll have to pay tax on that depreciation you previously took. The $30k tax you saved the year you bought it, you are now paying back. If you run into a situation where the car has dropped substantially in value and let's say you can only sell it for $80k, then you will only be liable to pay tax for $80k of depreciation recapture.

I always tell my clients when it comes to making business purchases - never make the purchase solely to save on taxes. Make the purchase because you need the item in order to do business.

One last item to keep in mind - there was a recent tax case where a depreciation deduction on a vehicle was disallowed because it wasn't owned by the business. I have also spoken with colleagues who've been through audits where vehicle depreciation was disallowed because title wasn't in the business's name.

Actually putting the vehicle in the business's name will require you to get commercial vehicle insurance, and might make it harder for you to qualify for financing. And after all that - you still have to track mileage for actual business-use even if the vehicle is owned by my business.

What are your options then if the G-Wagon deduction doesn't make sense for you?

1. You can still track and deduct mileage at the mileage rate
2. You can lease a vehicle through your business >> lease payments and actual expenses (insurance, gas, repairs) are deductible up to your business use percent. One VERY important note on leases >> if the value of the car you lease is greater than $60k (this was 2023's number, we don't yet have 2024) in the year of deduction and less than 6,000 lbs, you have to add-back a "lease inclusion" into your gross income, effectively reducing the amount you can deduct. There are specific tables each year that give these amounts (here is 2023's).

Another good rule to follow when thinking of making a large auto-purchase in your business: if you can't afford the car without the tax deduction, you can't afford it with it.

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# WRITE-OFF YOUR LIFE

There may or may not be tax influencer out there that says they can teach you to write off your life. They also may or may not charge several thousand dollars for it. They may or may not also have a client's return they prepared who is now under audit for tens of thousands of dollars in tax, fines and penalties for incorrectly taken deductions.

This idea that if you form a business you can now write off personal expenditures, is patently false. That's not to say you can't unlock deductions that you previously were unable to because they are now a component of your business (such as home office expenses, auto expenses), but personal expenses are and will always be not deductible.

Remember - in order to deduct an expense related to your business it must be ordinary and necessary for your business. I've seen clip after clip of influencers talking about how they write off everything from make-up to clothes to shoes to botox to nails because their "image" is part of their brand. These things (outside of very very limited circumstances) are not deductible.

The IRS even has an entire entertainment audit guide that all state the same thing - expenses having to do with your personal appearance are not deductible because you receive benefit from it outside of your business.

There are some circumstances where personal expense appearances can be deductible if the use does not extend outside of the business.

An example of this would be getting your hair or makeup done specifically for an event (but once it's over the hair and make-up get washed so there's no personal benefit), or getting your nails done because it was requirement of a job you were doing (maybe you were doing some hand modeling for a product). But something like botox, getting your hair dyed, or buying shoes for a photoshoot (that you inevitably wear again after) are all expenses that have benefit beyond just business use, and thus are not deductible.

There's a particular video on TikTok of a financial influencer (influencer might be too strong of a word here) talking about how he writes-off his custom $2,000 suits - by embroidering the name of his company inside the jacket! Boom! Checkmate IRS! Embroidering your logo on the inside of a custom suit does not unfortunately meet the requirements of being "ordinary and necessary" as a business expense.

In order to actually write-off clothes, they basically can't have any use outside of your work. That means a suit, shoes, etc that could potentially be worn outside of work (even if they're not), are not deductible. That leaves clothes/uniforms required of the job (such as scrubs, specific protective clothing, etc) that you're not also using outside of work. Normally these types of clothes are so specific and unique to the work you're doing, you would not wear them outside of work anyway, which is why the courts allows them in those specific circumstances.

I couldn’t close out this topic without talking about Chesty Love, possibly the most famous taxpayer win against the tax court surrounding a personal appearance deduction.

Chesty Love was an exotic dancer in the 80s, and successfully challenged the IRS in court to deduct her breast enhancements as a business expense. As discussed above, such physical enhancements are normally not deductible due to the personal benefits they provide.

However, Love's case was different for two main reasons: First, she demonstrated that her enhancements, which were extremely large at 56FF, caused her personal distress. She argued she suffered both from physical pain from their size (they were 10lbs each) and was mocked in everyday life. Because of this, the implants did not offer any personal benefit, but rather detracted from her personal life. Second, she proved that her income doubled post-surgery, directly linking the enhancements to her professional success.

This led to the court allowing her surgical costs as a legitimate business deduction, underlining the extraordinary nature of her case where the enhancements were deemed "freakish" and purely for business purposes.

As you can see, there is a very narrow set up circumstances for when anything related to your appearance is considered a legitimate business expenses infront of the IRS so tread very carefully in what you’re deducting.

# CLOSING THOUGHTS

I want to take a moment to thank you for spending time reading this ebook. Somedays it feels as if I'm battling a tide of misinformation when it comes to tax advice I see given on social media. What's so frustrating for me is there are real, monetary consequences when people utilize tax strategies incorrectly. As always, when in doubt, I encourage you to seek professional tax help if you're unsure of what you're doing. Unless that professional help is telling you that you can write-off your life, then run as fast as you can in the opposite direction.