TRUMP ADMINISTRATION HALTS RESIDENTIAL EVICTIONS UNTIL DECEMBER 31, 2020

Yesterday, the Trump administration announced an order temporarily halting certain residential evictions until the end of the year. The eviction moratorium, which is being enacted by the Centers for Disease Control and Prevention pursuant to its authority under Section 361 of the Public Health Service Act (42 U.S.C. § 264 *et seq.*), seeks to prevent the further spread of COVID-19. The nationwide moratorium could apply to as many as 40 million residential tenants.

Despite its reach, the moratorium is not a blanket protection for all residential tenants. To qualify for protection under the moratorium, a tenant must expect to earn no more than $99,000 this year (or no more than $198,000 if filing a joint tax return), or not have been required to report any income in 2019 to the IRS, or have received a stimulus check under the CARES Act. Further, a tenant must provide a sworn declaration to his or her landlord indicating that (1) the tenant has used best efforts to obtain government assistance, (2) the tenant is unable to pay full rent because of a loss of household income or extraordinary medical expenses, (3) the tenant is using best efforts to make partial rent payments, and (4) eviction would cause the tenant to be homeless or live with others in close quarters.

The moratorium does not relieve a tenant of his or her obligations to pay rent, and a landlord may continue to charge applicable interest, penalties, and fees under the lease for nonpayment of rent. Landlords also may still evict tenants for reasons besides not making rent, such as criminal activity, threatening the health and safety of other tenants, damaging property, and violating other provisions under the lease. Landlords who violate the order may face criminal penalties.

The order does not apply to commercial leases, nor does it apply in any state or local area that already has a moratorium on residential evictions that provides the same or greater level of protection. Nothing in the order precludes states or local authorities from imposing additional requirements.

O'Neil Cannon remains open and ready to help you. For questions or further information relating to the eviction moratorium, or insolvency concerns relating to bankruptcy or receivership, please contact the authors of this article, attorneys Jessica K. Haskell and Nicholas G. Chmurski.

EMPLOYMENT LAWSCENE ALERT: EMPLOYERS MUST IMMEDIATELY DECIDE WHETHER TO IMPLEMENT SEPTEMBER 1, 2020 PAYROLL TAX DEFERRAL

On August 8, 2020, President Trump issued an Executive Memorandum directing the Secretary of the Treasury to defer the withholding, deposit, and payment of the employee portion of the Social Security tax (6.2% of wages) for the period beginning on September 1 and ending on December 31, 2020. The deferral applies for employees whose pre-tax bi-weekly wages or compensation is less than $4,000. On an annualized basis, this equates to a salary not exceeding $104,000.

The IRS recently issued limited guidance on the implementation of the deferral. Open issues and takeaways are summarized below.

Additional Detail

In addition to calling for the deferral of the payroll tax, the Memorandum directs the Secretary to explore avenues for eliminating the taxpayers' obligation to repay the deferred taxes in the future. It should be noted that only Congress, not the Secretary, has the authority to waive taxes.

The Memorandum does not provide detail on how the payroll tax deferral will be implemented. In related interviews, the Secretary commented that, while he hoped that many companies would participate, he couldn't force employers to stop collecting and remitting payroll taxes. In other words, he suggested that the payroll tax deferral would be voluntary—a proposition not included in the Executive Memorandum.

Requests for Clarification

Uncertainty surrounding how to implement the payroll tax deferral resulted in requests from multiple trade groups for clarification, including an August 18 letter signed by 33 trade groups, including the U.S. Chamber of Commerce. The letter, submitted to the Secretary and to the respective leader of the U.S. Senate and of the U.S. House of Representatives, notes that under current law, the Memorandum creates a substantial tax liability for employees at the end of the deferral period.

While the stated purpose of the Memorandum was to provide wage earners with additional available spending money, unless Congress later acts to forgive liability for the deferred payroll tax, the affected earners will owe an increased tax bill next year. As the U.S. Chamber

of Commerce letter maintains, the deferral "threatens to impose hardship on employees who will face a tax bill" in an amount of double the usual payroll deduction for Social Security (amounting to 12.4% of employee wages) in the first four months of 2021.

The following chart illustrates the U.S. Chamber of Commerce's assessment of the magnitude of the potential tax bill for employees compared to the immediate benefit of the deferral:

Annual Income	Bi-Weekly Pay	Increase in Take-Home Pay by Pay Period	Tax Bill Due in 2021 (based on 9 pay periods)
$35,000	$1,346.15	$83.46	$751.15
$50,000	$1,923.08	$119.23	$1,073.08
$75,000	$2,884.62	$178.85	$1,609.62
$104,000	$4,000	$248.00	$2,232.00

The U.S. Chamber of Commerce letter further states that many of its employer members would likely decline to implement the deferral, choosing instead to continue to withhold and remit to the government the payroll taxes required by law.

IRS Notice 2020-65

Late in the afternoon on August 28, 2020, the IRS issued Notice 2020-65 to provide guidance regarding the payroll tax deferral. The Notice clarifies that any deferred amounts must be recouped by being collected from employee wages and repaid during the period between January 1, 2021 and April 30, 2021. Interest and penalties begin to accrue May 1, 2021 on any unpaid amounts. While the Notice is silent on the issue, it is presumed, because of the normal operation of payroll tax law, that employers would be responsible for paying any interest and penalties that accrue, in addition to paying any underlying deferred amounts that cannot be collected from employees.

Some questions about how to implement the deferral remain unanswered by the IRS guidance. Specifically, the guidance addresses neither self-employed individuals nor the method for reporting the deferral of taxes on IRS Forms 941 or W2. The guidance is also silent on how to collect deferred tax for an individual who is no longer employed for all or part of the 2021 repayment period. Staffing agencies, in particular, are concerned about employer exposure to the repayment cost in the event that employees for whom taxes were deferred are no longer employed during the repayment period. It is not clear that deducting the amount owed from an employee's final paycheck would be specifically permitted under either federal or state law, or any applicable bargaining agreements.

Decisions, Decisions

While some employers may welcome the ability to offer the payroll tax deferral to employees as a current relief measure, others may view with some reluctance the prospect of exposure to additional payroll tax costs coupled with the need to re-code payroll software effective September 1, 2020, January 1, 2021, and May 1, 2021. Implementing the current deferral and future double collection would also require careful and accurate communication to employees.

The IRS guidance leaves the door open for employers to avoid, rather than to implement the deferral, and to proceed, instead, to process payroll according the normal procedures. In the language of the guidance, an employer may, "if necessary, . . . make arrangements to otherwise collect the total Applicable Taxes from the employee."

O'Neil, Cannon, Hollman, DeJong and Laing remains open and ready to assist you. To discuss how the Memorandum, IRS guidance, and practical considerations relevant to the payroll tax deferral may apply to your business objectives and circumstances, please speak to your regular OCHDL contact.

JOHN G. GEHRINGER NAMED 2021 BEST LAWYERS® "LAWYER OF THE YEAR"

John G. Gehringer was recently recognized by Best Lawyers as the 2021 "Lawyer of the Year" for Construction Law.

Only a single lawyer in each practice area and designated metropolitan area is honored as the "Lawyer of the Year," making this accolade particularly significant. Receiving this designation reflects the high level of respect a lawyer has earned among other leading lawyers in the same communities and the same practice areas for their abilities, their professionalism, and their integrity.

In addition to the "Lawyer of the Year" award, John G. Gehringer was also listed in the 2021 Edition of *The Best Lawyers in America* in the following practice areas:

- Commercial Litigation
- Corporate Law
- Real Estate Law

Best Lawyers has published their list for over three decades, earning the respect of the profession, the media, and the public as the most reliable, unbiased source of legal referrals. Since it was first published in 1983, *Best Lawyers* has become universally regarded as the

definitive guide to legal excellence.

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20 OCHDL LAWYERS SELECTED AS 2021 BEST LAWYERS®; ANOTHER 5 NAMED BEST LAWYERS: ONES TO WATCH

We are pleased to announce 20 of our lawyers have been included in the 2021 Edition of *The Best Lawyers in America,* and an additional five have been selected as 2021 *Best Lawyers: Ones to Watch*.

The following are the O'Neil, Cannon, Hollman, DeJong and Laing lawyers named to the 2021 lists:

Best Lawyers in America

- Douglas P. Dehler – Litigation – Insurance
- James G. DeJong – Corporate Law, Mergers and Acquisitions Law, and Securities / Capital Markets Law
- Seth E. Dizard – Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law and Litigation – Bankruptcy
- Peter J. Faust – Corporate Law and Mergers and Acquisitions Law
- John G. Gehringer – Commercial Litigation, Construction Law, Corporate Law, and Real Estate Law
- Joseph E. Gumina – Employment Law – Management and Litigation – Labor and Employment
- Dennis W. Hollman – Corporate Law and Trusts and Estates
- Grant C. Killoran – Commercial Litigation and Litigation – Health Care
- JB Koenings – Corporate Law
- Dean P. Laing – Commercial Litigation, Personal Injury Litigation – Plaintiffs, and Product Liability Litigation – Defendants
- Gregory W. Lyons – Commercial Litigation and Litigation – Insurance
- Patrick G. McBride – Commercial Litigation
- Thomas A. Merkle – Family Law

- Joseph D. Newbold – Commercial Litigation
- Chad J. Richter – Business Organizations (including LLCs and Partnerships) and Corporate Law
- John R. Schreiber – Bankruptcy and Creditor Debtor Rights / Insolvency and Reorganization Law and Litigation – Bankruptcy
- Jason R. Scoby – Corporate Law
- Steven J. Slawinski – Construction Law

Best Lawyers: Ones to Watch

- Kelly M. Spott – Trusts and Estates
- Trevor C. Lippman – Litigation – Trusts and Estates
- Erica N. Reib – Labor and Employment Law – Management and Litigation – Labor and Employment
- Christa D. Wittenberg – Commercial Litigation

About Best Lawyers

Best Lawyers has published their list for over three decades, earning the respect of the profession, the media, and the public as the most reliable, unbiased source of legal referrals.

Best Lawyers: Ones to Watch recognizes associates and other lawyers who are earlier in their careers for their outstanding professional excellence in private practice in the United States.

Lawyers on *The Best Lawyers in America* and *Best Lawyers: Ones to Watch* lists are divided by geographic region and practice areas. They are reviewed by their peers on the basis of professional expertise, and they undergo an authentication process to make sure they are in current practice and in good standing.

EMPLOYMENT LAWSCENE ALERT: ACTION REQUIRED BY AUGUST 31, 2020 FOR CERTAIN RETIREMENT-RELATED CARES ACT RELIEF

An August 31, 2020 deadline applies both to individual retirement account participants who want to repay a required minimum distribution received in 2020 and to employer plan sponsors who wish to reduce or suspend certain 401(k) or 403(b) safe harbor employer

contributions. Details on each of these special tax relief provisions are summarized below.

Employers and individuals who wish to avail themselves of these special tax relief provisions should take prompt action.

Deadline for Repayment of Certain Waived 2020 Required Minimum Distributions

As we've described previously, tax law generally requires a 401(k), 403(b), or 457(b) retirement plan participant, or IRA owner, to take required minimum distributions (RMDs) annually once the owner reaches age 72 (or 70 ½ under the SECURE Act).

In late March 2020, the CARES Act waived the requirement to take an RMD from a retirement plan or IRA in 2020. For retirement account owners who had already taken 2020 RMDs and did not need them, the CARES Act provided a way to return them. Although RMDs are not usually eligible for rollover treatment, the CARES Act repayment mechanism is to treat the waived RMDs as if they are distributions eligible for rollover. Instead of actually rolling the amount over to a different plan, however, the CARES Act permits a 2020 waived RMD amount to be repaid only to the same account that paid it out. Any repayment, as described in the CARES Act, was required to take place within the standard 60-day window for making a rollover from one tax-favored account into another.

Because the CARES Act was passed in late March, the 60-day repayment period had by then already expired for those who had taken an RMD in early January 2020. The more recent IRS Notice 2020-51 extends the 60-day window period, so that any waived RMDs received on or after January 1, 2020 may now be repaid, provided that such repayment occurs by August 31, 2020.

Employer plan sponsors may also wish to review whether their plan document should be amended by the deadline to accept RMD repayments if their participant population desires to repay previously-distributed 2020 RMDs to the plan.

Employer Deadline to Reduce or Suspend 401(k) or 403(b) Safe Harbor Contributions

In a separate announcement, Notice 2020-52, the IRS has provided special relief to employer plan sponsors of 401(k) and 403(b) retirement plans who wish to make a mid-year reduction or suspension of safe harbor nonelective employer contributions. The ability to take such action expires on August 31, 2020 and should be properly documented as of that date.

Background

More and more employer sponsors of workplace retirement plans, in recent years, have chosen to adopt a "safe harbor" employer contribution feature. The key advantage of safe

harbor status for a tax-qualified retirement plan is that the plan is deemed to treat highly and non-highly compensated employees fairly, with respect to one another. It is therefore exempt from the otherwise applicable annual nondiscrimination testing.

In exchange for safe harbor status and the perk of avoiding complex and sometimes costly nondiscrimination testing, a safe harbor plan must meet certain requirements, including committing to provide a minimum employer contribution or formula, immediate vesting of the contributions, and the provision of an informational notice regarding the contributions before the beginning of the plan year (a safe harbor notice).

The Safe Harbor 12-Month Rule

Typically, once a safe harbor provision is adopted for a retirement plan, it must be in effect for all 12 months of the plan year. This requirement is intended to prevent employers from avoiding nondiscrimination testing if they do not honor the corresponding requirement to contribute to the plan for the benefit of participants.

Generally, there are two exceptions to the 12-month rule that permit a mid-year suspension or reduction of the safe harbor contribution:

1. The first applies if the employer is operating at an economic loss for the plan year.
2. The second applies if the safe harbor notice explicitly reserves to the employer the right to amend, reduce, or suspend the safe harbor contribution during the year.

Under either exception, an additional notice of amendment, reduction, or suspension must be provided to all participants at least 30 days in advance of the effective date of such action. As a result of any mid-year change to a safe harbor contribution, a plan is required to pass nondiscrimination testing in lieu of relying on the safe harbor testing exemption for the year.

Temporary Relief Related to Mid-Year Safe Harbor Nonelective Contribution Changes and Notices

IRS Notice 2020-52 provides special relief under which employers may make a prospective mid-year suspension or reduction of safe harbor nonelective contributions to 401(k) and 403(b) plans after March 13, 2020, for the balance of the year, regardless of whether the employer has satisfied either the requirement of incurring an economic loss or of previously providing a safe harbor notice reserving the right to change contributions.

Additionally, for safe harbor nonelective contribution plans, rather than providing the revised safe harbor notice at least 30 days before the effective date of the suspension or reduction, the notice must be provided by August 31, 2020.

This relief is time-limited, however. To take advantage of these special rules, a plan

amendment suspending or reducing the safe harbor contribution must be adopted by August 31, 2020.

Note that the relief provided in IRS Notice 2020-52 does not apply to a mid-year reduction of 401(k) safe harbor *matching* contributions. This is because of the IRS's view that matching contribution levels as communicated to employees directly affect employee decisions regarding elective contributions and should therefore not be changed.

Note also that this article does not address the implications of certain SECURE Act changes to the safe harbor notice requirement, of the impact of IRS Notice 2020-52 thereon.

Conclusion

The temporary relief provided in IRS Notices 2020-51 and 2020-52 will respectively assist individual taxpayers seeking to avoid taking RMDs in 2020, and employer plan sponsors seeking 2020 cost reductions. In either case, action to take advantage of the relief must be taken by August 31, 2020.

The attorneys of the Labor and Employment Group of O'Neil Cannon are actively monitoring COVID-19 developments and are available to assist employers with related employment law and employee benefit plan compliance matters. Please contact us if you need assistance in amending your employer-sponsored retirement plan to accommodate mid-year safe harbor changes or the return of 2020 RMDs.

DON'T BE CAUGHT OFF GUARD BY THE TAX AND LEGAL CONSEQUENCES OF YOUR NEW QUARANTINE HOBBY (PART 3 OF 3)

The coronavirus pandemic has forced most of us to stay home, and as a result, we are all looking for hobbies to pick up while we are social distancing. For some, quarantine hobbies have become Netflix binge watching or mastering bread baking. For others, creative passions and hobbies such as selling handmade crafts on Etsy or unwanted junk on eBay have become sources of income. If you are dabbling in a quarantine hobby that produces income, this article describes some good business practices that are important for every business.

Be sure to also check out Part 1 of our series here, where we provide some tips for choosing between legal structures in order to better protect yourself and your business and Part 2 of our series here, where we explore the tax issues relating to your business.

Set up a separate business checking account

Opening a bank account for your business is one of the most obvious ways to show the IRS that you really are in business. Even though you might be the only person accessing funds, it is a good idea to keep your personal and business finances completely separate. Not only will this help legitimize your activity as a business, but it will be immensely helpful come tax time.

If you maintain a separate account for only business transactions, you will have a clean record of all your business expenses at the end of the year. This will prevent you from accidentally forgetting that the book of stamps you purchased was actually for home use and help you easily identify tax deductible business expenses when you are filing your taxes. If you mix personal and business finances, this process will be much more time consuming and could result in some hefty accounting fees (if you need to pay an accountant to sort it all out).

Additionally, mixing your personal and business finances could cause you to lose your business's limited liability protection. Setting up different bank accounts for your business and personal needs helps establish the business as a separate entity and protects you, as the owner, from having to satisfy business debts with your personal assets.

Obtain an EIN

A federal employer identification number (EIN) is a nine-digit number the IRS assigns to businesses for tax filing and income reporting purposes. The IRS uses the EIN to identify the taxpayer. EINs must be used by business entities—corporations, partnerships, and limited liability companies. However, most sole proprietors do not need to obtain an EIN and can use their Social Security numbers instead. Even though a sole proprietorship does not need to obtain an EIN, it may be in your best interest to obtain an EIN anyway.

There are a few good reasons to use an EIN instead of your Social Security number. First, obtaining an EIN allows you to avoid having to provide your Social Security number to clients and other members of the public. Obviously, keeping your Social Security number private limits your exposure to identity theft. Additionally, using an EIN on your tax returns and payments to others also helps to show that you're a legitimate business—in other words, this isn't just a hobby, it's separate from your personal activities. Lastly, some banks require you to have an EIN before they will set up a bank account for your business.

The good news is that obtaining an EIN is easy and free! The fastest and easiest way is to apply for an EIN is directly through the IRS website. The IRS has an online EIN Assistant tool you can use. If you are not comfortable sending information via the Internet, you can download IRS Form SS-4, *Application for Employer Identification Number*, and send it to the

IRS by mail.

Maintain a good business record-keeping system

To prove to the IRS you did, indeed, make those purchases for your business, you will need a paper trail to back up your claims. Therefore, maintaining a good business record-keeping system that keeps your receipts and purchases organized is vital. Technically, if you do not have these records on file, the IRS can disallow your deduction. The IRS recommends keeping the following types of expense documents for your business:

- Account statements and invoices;
- Canceled checks;
- Credit card receipts and statements;
- Cash slips for cash payments; and
- Receipts for all entertainment, gift, transportation, and travel expenses.

The amount of time you should keep these documents varies between three years to indefinitely depending on the type of tax return you file, but the longer you keep them, the better protected you'll be if you're audited. The general rule of thumb is at least seven years—so do not immediately throw away your receipts after you have filed your taxes!

If maintaining a paper trail and a heavy file cabinet in your basement isn't your thing, an electronic record-keeping service like QuickBooks can help, since you always have a digital copy of your records available, and the calculations are always quick and accurate. Without a solid accounting software system, daily bookkeeping tasks will put a major strain on your time, and this burden will only become greater as your business grows. Regardless of the record-keeping system you choose, maintain an exhaustive record of all your finances in one place and strive to save and record receipts on at least a weekly, if not daily, basis.

Register the business with a state as a limited liability company, partnership, or corporation

Once you have chosen a legal structure for your business as detailed in Part 1 of our series, make sure you register the business with the state in which you are doing business if you chose to operate as a limited liability company (LLC), partnership, or corporation. Businesses that operate as a sole proprietorship generally are not required to register, and some states may not require registration for a small partnership either. The forms and the information required to register will differ based on the type of business being registered. But generally, the forms allow you to register a name for your business, and they also require certain information, such as the address, key officers, and the name of a contact person who will receive legal notices.

Comply with other state and federal tax laws, including collecting sales taxes and

paying annual state business renewal fees or franchise taxes

***Annual statement or report*.** Many states require corporations and LLCs to submit annual reports so they can keep clear records regarding these entities. The annual report will include your entities name, your office address, and your registered agent information. The purpose of the annual report is to keep the state updated with your entities' contact information. If you fail to file your annual report, the state may automatically dissolve or shut down your business. A biennial statement may also be mandated by some states. A fee is generally required with a statement or report submission, typically ranging from $10 to over $300.

Franchise tax. Some states require corporations or LLCs to pay an annual tax to operate, which is usually called a franchise tax. The amount of the tax depends on the state collecting it and is determined through formulas based on varying criteria, such as annual revenue collection or the number of shares issued by a company.

Sales tax. You may be required to collect sales tax in your state as well. You generally collect sales tax for the state in which you conduct business on orders that are placed within or delivered to a location within that same state. So, if your studio is in Milwaukee, and you are shipping to a customer in Madison, you will be expected to collect state sales tax on that order and pay it to the state of Wisconsin. If you are shipping an order from Milwaukee to Atlanta, it is unlikely that you will need to collect state sales tax. However, for online sellers in the e-commerce space, things are a little bit murky as to where you conduct your business, so be sure to read up on tax information for your primary state of business and any others you have dealings in. Additionally, in some states you may be required to obtain a sales tax permit to collect state sales tax. You can find information about each state's sales tax permit on that state's Department of Revenue website.

Consult with Legal and Tax Professionals

Before you launch your business, you should consult with legal and tax professionals to ensure you have considered all the legal and tax requirements. Legal counsel can help explain the implications of each legal structure and other important issues beyond the scope of this series, like whether you should trademark your company name or logo, or if you need patent, copyright or intellectual property protection for any of the products you are intending to sell. Tax professionals can help explain the tax implications of forming a sole proprietorship versus a partnership or a corporation and can help you manage and file your business taxes. While your local and federal government websites are an excellent place to begin your research, it is essential to have good counsel on call to solve legal and tax issues and to provide advice before diving into the world of a small business.

The thought of running your own business may seem a bit daunting at first, but our team at O'Neil Cannon is prepared and ready to help you. Please speak to your regular OCHDL

contact, or the author of this article, attorney Britany E. Morrison, to get your business up and running.

HEALTH CARE LAW ADVISOR ALERT: SELLING YOUR MEDICAL PRACTICE? MAKE SURE YOU HAVE TAIL COVERAGE.

When selling a medical practice, the physician-owner must consider multiple issues. From understanding the significance of the letter of intent, to complying with medical record transfer laws, to negotiating the purchase agreement, it can feel overwhelming.

One item to not overlook is the importance of obtaining medical malpractice insurance tail coverage.

To understand what tail coverage is, it is first necessary to understand the difference between a claims-made malpractice insurance policy and an occurrence-based malpractice insurance policy. To have coverage under a claims-made policy, the claim for coverage must be made while the insurance policy is in effect. Occurrence-based insurance, on the other hand, focuses on when the incident giving rise to the claim for coverage occurred. If a covered incident occurs while the occurrence-based insurance policy is in effect, coverage may be available even if the alleged bodily injury is not discovered until years later. So, tail coverage is necessary for claims-made insurance policies, but not for occurrence-based insurance policies. Tail coverage applies to claims-made insurance policies because the “tail” extends the insurance coverage beyond the termination date of the claims-made policy. This is critical because, by obtaining tail coverage, the insured physician will continue to have malpractice coverage for incidents that happened prior to the termination date of the policy, even if the claim occurs after the termination date.

With this termination date often being the date on which the physician sells his or her medical practice, this tail coverage provides valuable peace of mind and liability protection for the selling physician. Accordingly, selling physicians with a claims-made medical malpractice insurance policy should consult their advisors, including their insurance agent, to ensure that tail coverage is in place in connection with the sale of their practice.

Jason Scoby is a shareholder and a member of the firm’s Business Law, Mergers and Acquisitions, and Banking, Receivership, and Creditors’ Rights Practice Groups. He advises and represents individuals, businesses, and banks on a variety of corporate, banking, and business-related issues, including mergers and acquisitions, commercial loan transactions,

corporate issues, contract negotiation and preparation, and business entity selection and formation.

DON'T BE CAUGHT OFF GUARD BY THE TAX AND LEGAL CONSEQUENCES OF YOUR NEW QUARANTINE HOBBY (PART 2 OF 3)

The coronavirus pandemic has forced most of us to stay home, and as a result, we are all looking for hobbies to pick up while we are social distancing. For some, quarantine hobbies have become Netflix binge watching or mastering bread baking. For others, creative passions and hobbies such as selling handmade crafts on Etsy or unwanted junk on eBay have become sources of income. If you are dabbling in a quarantine hobby that produces income, this article will address the tax-filing consequences, so they do not catch you off guard.

For helpful tips on choosing a legal structure for your business to better protect yourself and your business, check out part 1 of our series (linked here). Part 3 of our series will discuss good business practices for running your business.

Is it a Hobby or is it a Business?

The rules for how to report the income and expenses of your activity depend on whether you and the IRS classify your activity as a hobby or as a business for tax purposes. Distinguishing between a hobby and a business is not an exact science. In fact, the IRS's definition of a hobby is not entirely helpful, since it simply classifies a hobby as an activity that you engage in "for sport or recreation, not to make a profit."

Nevertheless, the IRS has provided a nonexclusive list of nine factors to be used in determining whether an activity is a legitimate business or a hobby:

1. Do you carry on the activity in a businesslike manner and maintain complete and accurate books and records?
2. Does the time and effort you put into the activity indicate an intention to make a profit?
3. Do you depend on income from the activity for your livelihood?
4. Are there losses? Are they due to circumstances beyond your control (or are they normal in the startup phase of your type of business)?
5. Have you changed your methods of operation to improve profitability?
6. Do you or your advisors have the knowledge needed to carry on the activity as a successful business?
7. Were you successful in making a profit in similar activities in the past?

8. Does the activity have the ability to make a profit in the next few years?
9. Can you expect to make a future profit from the appreciation of the assets used in the activity?

Additionally, the IRS provides a safe-harbor rule that presumes an activity to be a business versus a hobby if it has a profit in at least three of the last five years. If you have answered yes to a few of these questions or you have met the safe-harbor rule, then you most likely have a business. But if you answered no to the majority of these questions and you do not meet the safe-harbor rule, the IRS will most likely classify your activity as a hobby. The tax implications of each are explained further below.

Activity Classifies as a Hobby

If your activity is classified as a hobby, you will have to report any income you make from that hobby on your personal tax return, Form 1040, on Schedule 1, line 8, "Other Income." The income reported will be subject to income tax but not subject to self-employment tax (an additional 15.3%) as it would be if it were classified as a business.

The downside of classifying an activity as a hobby is that you cannot deduct any hobby-related expenses. Due to a change made as part of tax reform (the elimination of miscellaneous itemized deductions under the Tax Cuts and Jobs Act (TCJA)), beginning in 2018 and continuing to 2025 unless the TCJA is otherwise extended, you are no longer eligible to take a deduction for hobby expenses. This means that under the TCJA you cannot deduct any hobby expenses, but you still must report 100% of any revenue from the hobby activity as income and pay income taxes on it. And since you cannot use hobby expenses to reduce your hobby income, you will not be able to use a loss from hobby sales to reduce other income. This can be important if you make money in other activities that you intended to offset with losses.

Activity Classifies as a Business

If your activity classifies as a business or your hobby becomes a business, you are subject to a whole distinct set of tax rules. First, you will typically have to report your net income on Schedule C on your personal tax return, Form 1040. Your net income is the money you make selling your items *minus* eligible business expenses. Therefore, unlike an activity classified as a hobby, you can deduct eligible business expenses. This is a great benefit because eligible business expenses lower your taxable income, thereby lowering the amount of tax you owe as part of your tax return.

However, to be a deductible expense, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your trade or business. Typical deductible eligible business expenses for online sellers include expenses

such as:

- Fees paid to the online site/marketplace
- Cost of materials and equipment
- Shipping costs
- Bank fees
- Use of dedicated space in your home/studio for a workshop
- Legal and professional fees

To find out what deductions are available to claim and how to correctly claim those deductions, it is especially important to keep detailed records of all expenses and consult a professional, like a CPA or tax attorney. In addition, IRS Publication 535, *Business Expenses*, is a great resource that discusses common business expenses and explains what is and is not deductible.

Although you can deduct eligible business expenses if your activity classifies as a business, you could be subject to self-employment taxes. If the net income you report on your Schedule C is $400 or more, unlike an activity classified as a hobby, you will be subject to self-employment tax in addition to income tax on your activities' earnings.

When you work as a traditional employee, your employer withholds a certain amount of money from every paycheck, which goes to pay employment taxes – 15.3% (12.4% for Social Security and 2.9% for Medicare). Half of that amount is covered by your employer, but running your own business means you are responsible for the full 15.3%, which is called the self-employment tax. You will have to manage the payment of these taxes throughout the year if you expect to pay $1,000 or more in taxes, which comes in the form of quarterly estimated tax payments. If you do not make these payments, you could be charged penalties and interest for not paying the taxes in a timely manner. For a more detailed discussion on estimated tax payments see the article here.

Despite being subject to self-employment tax, there is still a significant advantage in the fact that you can deduct eligible business expenses if your activity classifies as a business versus a hobby. However, it is important to make sure you legitimize your business in the eyes of the IRS. Part 3 of this series will focus on good business practices that are not only important for every business but help you to classify your activity as a legitimate business for tax purposes.

Bottom Line

If you are dabbling in a quarantine hobby that produces income, be sure you understand the differences between a hobby and a business for tax purposes and the tax-filing consequences of each. While declaring income earned from your hobby may seem like a hassle — especially since you cannot deduct expenses beginning in 2018 — you do not want to get in trouble

with the IRS for not reporting all your income. Additionally, if the IRS decides you incorrectly classified your hobby as a business or vice versa, you could face additional taxes, penalties, and interest.

Please check back the next week for our last article in the series, which will address good business practices for operating and running an online business. And, If you are interested in learning more about the differences between a hobby and a business for tax purposes and how it might affect your tax filing requirements, or how to incorporate or organize a business entity, please contact the author of this article attorney Britany E. Morrison at O'Neil Cannon to discuss how we are able to assist you.

DON'T BE CAUGHT OFF GUARD BY THE TAX AND LEGAL CONSEQUENCES OF YOUR NEW QUARANTINE HOBBY (PART 1 OF 3)

The coronavirus pandemic has forced most of us to stay home, and as a result, we are all looking for hobbies to pick up while we are social distancing. For some, quarantine hobbies have become Netflix binge watching or mastering bread baking. For others, creative passions and hobbies such as selling handmade crafts on Etsy or unwanted junk on eBay have become sources of income. If you are dabbling in a quarantine hobby that produces income, here are some tips for choosing between legal structures in order to better protect yourself and your business.

Whether you have just started selling your handmade crafts online, or you are a veteran in the trade, one of the most important legal questions for online sellers to determine is: **What is the best legal structure for my business?** This article will help you decide on the best way to structure your newly founded business.

Please check back in the next two weeks for our other articles, which will address tax issues relating to your online business, and good business practices for operating and running an online business.

Remember, your online business is a *business* whether you like it or not, so please think about the appropriate business structure

Your online business is your business, and it is important that you set up your business as a legal business entity. There are a number of legal business structures to choose from. Which business structure you choose will impact the taxes you pay, the paperwork you are required

to file in order to establish your business, and whether you can be held personally liable if someone sues your business. The most common legal structures are as follows and will be described in detail below:

- Sole proprietorship
- Limited liability company
- Corporation

Easy as 1, 2, 3: Sole Proprietorships

A sole proprietorship is an unincorporated entity, which is the easiest and cheapest way to operate your business; however, it comes with more risks than a limited liability company or corporation. With a sole proprietorship, you don't need to file any legal forms with the state you are operating in or pay any fees to the state to establish your sole proprietorship. If you have already sold one handmade craft, you're technically operating a sole proprietorship and no legal paperwork is needed to be filed. That was easy, right?

If you are operating as a sole proprietorship but would prefer to operate under a different name other than your own, you may need to file a certificate with your state for a "DBA" or "doing business as" name. For example, if your name is Bob Smith then technically your sole proprietorship is also named Bob Smith. However, if Bob sells handmade fishing poles on his online shop, he can choose to do business as "Bob's Fantastic Fishing Poles" or any other name he chooses to do business as.

Further, depending on what you're selling and where you're selling from, you may also need to obtain certain business licenses (e.g., a seller's permit). Therefore, before you start selling, it's important to look up and comply with local and state laws to avoid violations and fines.

One of the major drawbacks with operating a business as a sole proprietorship is the fact that you may face personal liability if someone is harmed or injured by your handmade crafts and you end up being sued. Not only are you risking your online business's livelihood, you could also be risking your home, your car, the money in your bank account, and more. All those things might not be worth risking for a few hundred dollars in your pocket, right? If you are selling handmade crafts that come with even a slight risk of being injurious, toxic, or harmful to individuals, we highly recommend that you consider incorporating or organizing your business through a corporation or limited liability company, which is described in more detail below.

Uncharted Waters: Limited Liability Companies and Corporations

Whether you have quit your day job to make custom wooden tables or are merely crafting and selling earrings out of your basement as a hobby, it is still a good idea to form a limited liability company or corporation to protect yourself from personal liability (as described

above).

Although forming a limited liability company or incorporating your business will be more expensive and time consuming than starting a sole proprietorship, the time and money will likely be worth it. In order to form a limited liability company or corporation you will need to pay fees and file paperwork with the Secretary of State (or similar office) in the state in which you intend to organize your limited liability company or incorporate your business. Depending on your needs and wants, it may make sense to research certain state laws to determine whether your home state or another state is best for formation of your new business.

A limited liability company and a corporation will both limit your personal liability to how much you put into the company. This means that if someone is to get injured from one of your business's handmade crafts, theoretically (if all corporate and limited liability procedures are followed) the most you could end up losing is the assets, including cash, that you have in the company. While this may not be an ideal situation, it is much better than losing your personal assets over a $10 set of earrings that harms an individual.

Lastly, the process of incorporation typically requires more time and money than other legal entities. Not only does a corporation require a board of directors and more formal requirements than that of a limited liability company (like holding regular board meetings and recording minutes), a corporation is taxed differently than a limited liability company, which could be a deciding factor on how you structure your newly founded online business.

The thought of incorporating or organizing a business entity may seem a bit daunting at first, but our team at O'Neil Cannon is prepared and ready to help you. Please speak to your regular OCHDL contact, or the authors of this article, attorney Britany E. Morrison, to get your business up and running.

TAX AND WEALTH ADVISOR ALERT: WHAT IS PROBATE AND WHY SHOULD I AVOID IT?

Probate is the legal process during which a court oversees the collection and transfer of a person's assets upon his or her death. In general, the probate process includes filing a will, appointing a personal representative, inventorying the decedent's assets, paying the decedent's debts, filing taxes, and distributing the balance of the estate according to the decedent's will. If the decedent did not leave a will, then the decedent's property is distributed according to Wisconsin's intestacy laws.

Many people seek to avoid probate because probate documents are public record, so avoiding probate means maintaining a sense of privacy. Additionally, the probate process can be very time consuming, ranging anywhere from six months to two years, and expensive. Expenses such as court costs, probate bonds, fees paid to the personal representative, and attorneys' fees can all add up to a significant amount by the end of the probate process. Because the estate generally pays for these costs, the probate process can significantly drain an estate and take away what you left behind for your beneficiaries.

With a good estate plan in place, it is possible for your estate to avoid the probate process, or at least lessen the process's impact on your estate. If you would like more information on estate planning options to avoid probate, please feel free to contact attorney Kelly M. Spott.