BRITANY MORRISON PUBLISHED IN STATE BAR'S INSIDETRACK

Attorney Britany Morrison authored an article entitled "Telecommuting: Tax Implications for Employers and Employees," which appeared in the State Bar of Wisconsin's newsletter**,** *InsideTrack*.

In the article**,** Morrison addresses a few important tax considerations for employers and employees working remotely. You can read the full article here.

For more information on this topic**,** contact Britany Morrison at 414-276-5000 or Britany.Morrison@wilaw.com.

TAX AND WEALTH ADVISOR ALERT: BREAKING NEWS–IRS SAYS EXPENSES PAID WITH FORGIVEN PPP LOANS ARE DEDUCTIBLE

Businesses can now deduct expenses paid for with the proceeds of a forgiven Paycheck Protection Program (PPP) loan. The IRS, in Revenue Ruling 2021-2 issued today, reversed its original position that prohibited businesses with PPP loans from "double-dipping" by paying expenses with a forgivable loan, then writing off those expenses. Congress, in the latest COVID-19 relief bill, as we explained further here, explicitly stated that such expenses were deductible, forcing the IRS to reverse course.

This ruling is sure to provide a significant tax benefit and relief for many small business owners who had availed themselves of the PPP program and found themselves saddled with unexpected tax liabilities as a result of the IRS's original position.

O'Neil, Cannon, Hollman, DeJong and Laing remains open and will continue to monitor federal and state law tax changes. For questions or further information relating to taxation under the CARES Act and the new relief bill, please contact Attorney Britany E. Morrison.

TAX AND WEALTH ADVISOR ALERT: NEW COVID RELIEF BILL SAYS EXPENSES PAID WITH FORGIVEN PPP LOANS ARE DEDUCTIBLE

Late Monday, Congress passed a $900 billion COVID-19 relief bill that includes a provision that allows business owners to claim tax deductions for expenses covered by Paycheck Protection Program (PPP) loan proceeds. The bill goes to President Donald Trump today, who is expected to sign it into law.

Among other tax provisions, the bill specifies that business expenses paid with forgiven PPP loans are tax-deductible. This supersedes IRS guidance (as we previously discussed here) that such expenses could not be deducted and brings the policy in line with what the American Institute of Certified Public Accountants (AICPA) and hundreds of other business associations have argued was Congress's intent when it created the original PPP as part of the $2 trillion CARES Act.

This congressional action is sure to provide a significant tax benefit for many small business owners who had availed themselves of the PPP program and found themselves saddled with unexpected tax liabilities.

O'Neil, Cannon, Hollman, DeJong and Laing remains open and will continue to monitor federal and state law tax changes. For questions or further information relating to taxation under the CARES Act and the new relief bill, please contact Attorney Britany E. Morrison.

TAX AND WEALTH ADVISOR ALERT: IRS CLARIFIES STANCE ON DEDUCTIBILITY OF EXPENSES COVERED BY PPP LOANS

Yesterday, the U.S. Treasury Department and Internal Revenue Service released guidance clarifying the tax treatment of expenses funded with forgiven Paycheck Protection Program loans. This guidance, Revenue Ruling 2020-27 and Revenue Procedure 2020-51, strengthened the Treasury's prior position in Notice 2020-32, as we previously wrote about here, which stated that expenses funded with forgiven PPP loan funds are not deductible.

In Revenue Ruling 2020-27, the IRS answered the question of whether a taxpayer who paid otherwise deductible expenses with PPP funds can deduct those expenses in the taxable year in which the expenses were paid or incurred if, at the end of that taxable year, the taxpayer reasonably expects to receive forgiveness of the PPP loan. The answer according to the IRS is "no," regardless of whether the taxpayer has submitted an application for forgiveness of the loan by the end of that taxable year.

The Treasury provided its rationale for this in a subsequent press release yesterday, stating "[s]ince businesses are not taxed on the proceeds of a forgiven PPP loan, the expenses are not deductible. This results in neither a tax benefit nor tax harm since the taxpayer has not paid anything out of pocket."

Nevertheless, if desired, Congress could override the Treasury's stance by passing a law that explicitly allows the deductions. Additionally, it is possible a taxpayer may decide to challenge this position in court.

However, based upon these current rulings, it is important for all taxpayers that are seeking PPP loan forgiveness to understand whether or not, and when, they can deduct expenses incurred with the loan proceeds and the tax impact that may arise from the lack of deductibility if the loan is forgiven. For questions or further information, please contact attorney Britany E. Morrison.

TAX AND WEALTH ADVISOR ALERT: NEW STREAMLINED FORGIVENESS FOR PPP LOANS UP TO $50,000

Late last week, the Department of Treasury and Small Business Administration (SBA) jointly released a new loan forgiveness application for Paycheck Protection Program loans of $50,000 or less. This new streamlined application removes calculations required on prior forms and simplifies documentation requirements, relieving both borrowers and lenders of the prior compliance burdens present in the older form.

Pursuant to an interim final rule, the simper one-page application form, SBA Form 3508S, does not require borrowers to reduce their forgiveness amount for any reductions in full-time equivalent (FTE) employees or in salaries or wages. Additionally, the new form does not require borrowers to show calculations used to determine their loan forgiveness amount. With that said, the SBA could request additional information and documents as part of its loan review process.

While simpler overall, the application still requires the borrower to make certain certifications regarding the accuracy of the information reported. Further, the application requires the borrower to submit documentation supporting the fact that the use of the loan proceeds was for eligible costs. Borrowers who, together with their affiliates (as determined under SBA rules), received loans of $2 million or more are ineligible to use the new streamlined application. For example, if an entity has a loan of $50,000 and its parent corporation has a loan of $1.95 million, the former would not be able to use Form 3508S to apply for loan forgiveness.

Form 3508S and its accompanying instructions are posted on the SBA's website.

O'Neil, Cannon, Hollman, DeJong and Laing remains open and ready to help you. For questions or further information relating to the new streamlined application for PPP loans under $50,000, please contact the author of this article, Attorney Britany E. Morrison.

TAX AND WEALTH ADVISOR ALERT: IRS REMINDS SELECT TAXPAYERS OF OCTOBER 15TH TAX FILING DEADLINE

The IRS has reminded taxpayers who filed an extension that the October 15, 2020 due date to file their 2019 tax return is near. Taxpayers should file their tax returns on or before the October 15, 2020 deadline. Moreover, taxpayers with tax due should pay as soon as possible to reduce any penalties and interest. However, certain taxpayers may have more time to file and pay. Taxpayers with more time to file or pay include the following:

- service members and others serving in a combat zone who typically have 180 days after they leave the combat zone to file returns and pay any taxes due; and
- taxpayers in federally declared disaster areas who already had valid extensions.

Further, taxpayers can make their federal tax payments online through various methods such as a bank account withdrawal or via debit card or credit card. Additionally, taxpayers unable to make full payments can meet their tax obligations in monthly installments by applying for a payment plan. Alternatively, taxpayers can find out if they qualify for an offer in compromise—a way to settle tax debt for less than the full amount or even request a temporary delay on collection until their financial situation improves.

The IRS also reminded those with little or no income who are not required to file a tax return (non-filers) that they could be eligible to receive an Economic Impact Payment.

O’Neil, Cannon, Hollman, DeJong and Laing remains open and will continue to monitor federal and state tax filing deadlines. For questions or further information relating to the upcoming October 15, 2020 deadline, please contact Attorney Britany E. Morrison.

TAX AND WEALTH ADVISOR ALERT: STRIKE WHILE THE GIVING IS GOOD—HISTORICALLY HIGH ESTATE AND GIFT TAX EXEMPTIONS MAY BE REDUCED OR ELIMINATED AS EARLY AS JANUARY 1, 2021

With the economy still struggling, one bright spot remains for those who are willing to make an investment of time and money in estate planning. The combination of lowered asset values, reduced interest rates, and historically high estate and gift tax exemptions present a unique opportunity to implement estate planning techniques that will yield significant tax savings. But those looking to take advantage of this unique opportunity should act now, because a rebound in asset values and the outcome of the November 2020 election may make this unique opportunity go away.

The Gift, Estate, and GST Tax Exemptions for 2020

The Tax Cuts and Jobs Act of 2017 created a significant opportunity to transfer wealth by effectively doubling the federal estate and gift tax exemption for transfers made after 2017. The current exemption for 2020 allows an individual to transfer up to $11,580,000 (or up to $23,160,000 for a married couple) over the course of his or her lifetime without incurring gift or generation-skipping transfer (“GST”) tax. Any unused amount is available to eliminate estate and GST tax upon the individual’s death. Moreover, a surviving spouse inherits the unused gift and estate tax exemption (but not the GST tax exemption) of the first spouse to die if an election is made on a timely filed estate tax return for the first spouse’s estate.

Any amounts gifted during life or transferred upon death in excess of the federal estate and gift tax exemption (over $11,580,000 for an individual or $23,160,000 for a married couple) are subject to a 40% estate and gift tax rate at death, plus any taxes that may be imposed by the decedent’s state of domicile (Wisconsin has neither an estate nor gift tax). In addition to the gift or estate tax, a separate GST tax of 40% is imposed on transfers in excess of the exemption amount that are made to grandchildren or more remote descendants.

The Scheduled Reduction of the Gift, Estate, and GST Tax Exemptions

Currently, the estate and gift tax exemptions are the **highest** they have ever been since the modern estate tax was implemented in 1916 (with the single exception of 2010, when the estate tax was briefly repealed). However, effective January 1, 2026, the exemption will be reduced to $5,000,000 (or effectively $10,000,000 for a married couple), adjusted for inflation back to 2010.

This means that while currently a married couple can transfer over $20,000,000 without estate or gift tax, if exemptions are cut in half as scheduled on January 1, 2026, then the same couple can only transfer approximately $10,000,000 without estate or gift tax. At a 40% tax rate, the couple creates an approximate $4,000,000 in savings by making a transfer today at current exemption levels. That is $4 million going to their beneficiaries rather than taxes!

And the good news is that gifts made now utilizing 2020's record-high exemptions may not be "clawed back" as provided in regulations published by the IRS, even if exemptions are later reduced on January 1, 2026, or eliminated by Congress sooner as explained below. The importance of these "anti-clawback" regulations is that taxpayers can utilize today's higher exemption amounts without fear of future penalty or "clawback" and should act before the scheduled reduction.

The Presidential Election

While a deadline of December 31, 2025, for the scheduled reduction may seem like plenty of time to take advantage of these high exemptions, the 2020 presidential and congressional elections and the impact of the pandemic may bring about some drastic changes to estate planning as soon as January 1, 2021.

First, there is a real possibility that taxes may be increased to support the massive amounts spent by Congress on COVID-19 relief. The gift, estate, and GST tax rates could be viewed as the easiest taxes to raise because they would impact only the wealthiest of taxpayers, and not those perceived to be struggling the hardest due to the novel pandemic. It is possible for the gift, estate, and GST tax rates to be increased from the current 40% to 55% or even higher.

Second, there is speculation that if the Democratic Party wins the presidency and gains control of Congress following the November 2020 election, the exemption amount might be reduced to an amount as low a $3,500,000 even before the expiration date of January 1, 2026. In fact, such a change could be effective as soon as January 1, 2021, if Congress passes legislation having retroactive effect.

Additionally, while the Democratic Party's presidential nominee, Joe Biden, has not proposed any specific changes to the estate exemption amounts and tax rates, his recently released economic plan calls for the "wealthiest Americans [to] shoulder more of the tax burden," including raising federal estate taxes "back to the historical norm." This seems to indicate that if Biden and the Democratic Party are successful come November, exemptions going forward could be significantly lower than they are under current law, and thus most tax commentators believe that the current exemption amounts are the best we are going to see.

Maximize Higher Gift, Estate, and GST Tax Exemptions Before It is Too Late—Plan Now!

Gifting assets outright or in trust now, while the exemption levels are still at their historic high, allows taxpayers to "lock in" these high exemption amounts without fear of a clawback or an exemption reduction as soon as January 1, 2021. There are several effective estate planning structures that can be used to take advantage of depreciated asset values, record-low interest rates, and record-high exemption amounts, but waiting for official election results come November 3 will likely make it difficult to implement these structures.

Some of these structures require several months to implement. Other than planning to reduce gift and estate taxes, there are many other considerations for taxpayers when transitioning wealth to their family, e.g., how and when to benefit family members; choosing trustees; choosing the state of trust administration for asset protection and income tax planning objectives; considering multi-generational planning; and charitable giving and identifying which assets to gift. Additionally, since certain assets may require professional valuations, these transactions may require more time to implement, so now is the time to act in order to ensure that the transactions can be completed before year's end.

Conclusion

The current confluence of lowered asset values, reduced interest rates, and historically high estate and gift tax exemptions may make this one of the best times in history to transfer wealth efficiently with minimal estate tax implications, but the time to act is now. Many estate planning techniques take time to implement, so do not wait until November 2020 to consider making changes to your estate plan.

Regardless of which political party stays in power or takes control in November, our team at O'Neil Cannon realizes that there is no one-size-fits-all strategy to address your estate planning goals and objectives. We are prepared and ready to help you build a comprehensive plan tailored to your needs. If you are interested in taking advantage of these unparalleled opportunities for tax savings, please speak to your regular OCHDL contact, or the author of this article, attorney Britany E. Morrison, to discuss how you can strike while the giving is good.

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.

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.