



**December 2024**

## Surprise: Related Party Rules Do Not Kill Prepaid Rent Strategy

In our 2024 year-end tax strategies for business deductions, we showed how you could pay 12 months' rent in advance on December 31 and deduct the full amount this year using the IRS safe harbor.<sup>1</sup>

Here's a twist on the example we used in the original article.

Say you operate your S corporation business on the cash basis and pay fair market rent to your single-member LLC that owns the building you use for the business.

- On Tuesday, December 31, 2024, your S corporation cuts a \$36,000 rental check for 12 months' rent to your single-member LLC and mails it using certified mail.
- On Thursday, January 2, 2025, the postman arrives at your home, has you sign the certified mail delivery receipt, and hands you the envelope containing the check payable to your LLC.
- On Friday, January 3, 2025, you deposit the rental check in your LLC's bank account.

**Result.** You obtain a 2024 rent deduction because your S corporation deducts the rent on its 2024 tax return and passes that lower income amount on a Schedule K-1 to your tax return. Your single-member LLC reports the rental income on Schedule E of your 2025 tax return.

### ***What Makes This Possible?***

Two rules make this possible:

1. The IRS safe-harbor rule on prepaid expenses
2. The fact that the related party rules do not apply to the cash basis taxpayers in this scenario

## ***IRS Safe Harbor***

The IRS has a “12-month rule” for prepaid expenses, which states:

*A cash basis taxpayer can deduct prepaid expenses in the year of payment if the right or benefit paid does not extend beyond the earlier of:*<sup>2</sup>

- *12 months after the right or benefit begins, or*
- *The end of the tax year following the year in which the payment is made*

You meet both rules. You paid no more than 12 months’ rent, and your rent payments do not go into 2026.

## ***No Related Party Disallowance***

**Technical note.** Your S corporation and your single-member LLC are related parties.<sup>3</sup> The tax code’s related party rules generally disallow losses and certain transactions between related parties.<sup>4</sup>

But when it comes to this prepaid rent strategy, the related party rule does not apply because both your solely owned corporation and your single-member LLC are on the cash basis.

The tax code’s related party “expense” rules apply to mismatches caused by reason of the method of accounting.<sup>5</sup>

In your case, you have no mismatch in accounting method. Both your S corporation and your LLC use the same method of accounting—the cash basis.

## ***Takeaway***

The safe-harbor prepaid rent strategy works for related parties that operate on the cash basis.

For details on making this strategy work, see [2024 Last-Minute Year-End General Business Income Tax Deductions](#).

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- 1 [2024 Last-Minute Year-End General Business Income Tax Deductions.](#)
- 2 [Reg. Section 1.263\(a\)-4\(f\).](#)
- 3 [IRC Section 267\(b\).](#)
- 4 [IRC Section 267.](#)
- 5 [IRC Section 267\(a\)\(2\).](#)

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