tax report

MAY 2017

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Business Auto Deductions

If you drive your car for business purposes, the costs of operating and maintaining your vehicle are potentially deductible. Here are some guidelines.

Two Methods

The IRS provides two basic methods for computing deductions for the business use of an automobile.

Actual expense method. With the actual expense method, you deduct the actual costs of operation and ownership, including licenses, registration fees, garage rent, repairs, gas, oil, tolls, and insurance. Additionally, you may claim depreciation deductions if you own the car or your lease payments if the car is leased. Owners may be able to elect expensing under Section 179; however, restrictions apply.

Standard mileage rate. Alternatively, you may choose to use an IRS-provided standard mileage rate. With this method, you multiply the number of business miles you drive during the year by the applicable rate (53.5¢ per mile for 2017). When you use the standard mileage rate, you don't separately deduct expenses such as gasoline, oil, insurance, repairs and maintenance, depreciation, or lease payments.

Which Should You Use?

If your vehicle is costly to own and operate, the actual expense method may be more advantageous. Conversely, if your vehicle is fuel efficient and/or inexpensive, the simpler standard mileage rate method may be a better choice.

With either method, the IRS requires that you keep records that substantiate your business use of the car: the date, place, business purpose, and number of miles you travel. When you use the actual expense method, you'll also need records substantiating the amount and date of car-related expenditures.

If you decide to use the standard mileage rate for a car you *own*, you may switch to deducting your actual business-related car expenses in a later year. However, you won't be able to claim accelerated depreciation deductions for the car. With a *leased* car, you have less flexibility. If you choose the standard mileage rate the first year, you must use it for the entire lease period.

Personal *and* Business Use

If you use your car for both personal and business purposes, you must keep track of your mileage for each purpose. To figure the percentage of qualified business use, divide the business mileage by the total mileage driven and then multiply that percentage by your total expenses. ■

Day Camp Expenses

When all requirements are met, employed and self-employed parents may claim a federal income tax credit for a portion of their child care expenses. Although parents typically claim the credit for day care and pre-school expenses, the credit may also be available for summer *day camp* expenses.

For 2017, the child and dependent care credit is calculated by multiplying the amount of qualifying expenses (up to $3,000 for the care of one individual or up to $6,000 for the care of two or more) by an applicable percentage (between 20% and 35%, based on income). Children must be under age 13 while attending camp, and other restrictions may apply.

Note that the costs of *overnight camp* are excluded from the definition of "employment-related expenses" that can qualify for the credit.

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Social Security Full Retirement Age

Under Social Security rules, a person may claim retirement benefits at any time after age 62, but the monthly benefit will be permanently reduced if the individual begins receiving benefits before reaching full retirement age (FRA). FRA, which is 66 for those born during the 1943–1954 period, is gradually increasing to 67. For those turning 62 in 2017 (born in 1955), FRA is 66 and two months. FRA will continue to increase by two months per year for those born in 1956–1960 — until it equals 67 for those born in 1960 or later. The monthly Social Security benefit increases for individuals who delay taking benefits until after their FRA (up to age 70).

Increase in Threshold for Medical Deductions

For 2017, all taxpayers claiming an itemized deduction for qualified medical expenses will have their deduction limited to expenses in excess of 10% of adjusted gross income (AGI). Previously, an exception set the threshold at 7.5% of AGI if the taxpayer or his/her spouse turned 65 during the tax year. However, that exception expired at the end of 2016.

The general information in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.

The "Nanny Tax"

If you hire someone to work for you in your home, you may have federal employment-tax responsibilities. The "nanny tax" rules can apply when you hire any type of household worker — a nanny, housekeeper, gardener, etc. — who is not an independent contractor.*

Social Security and Medicare taxes (FICA). Both the household employer and the employee must pay FICA tax. Generally, the Social Security tax is 6.2% of wages and the Medicare tax is another 1.45% (a total rate of 12.4% for Social Security and 2.9% for Medicare).

In 2017, you are responsible for paying (and withholding the employee's share) of FICA taxes if you pay your household employee $2,000 or more in cash wages. If you expect to meet the annual threshold, it's smart to begin withholding right from the start to avoid having to withhold additional taxes once the employee's pay reaches that threshold.

Income tax. As a household employer, you are not *required* to withhold federal income taxes from your employee's pay, but you *can* if your employee asks you to do so.

Federal unemployment tax (FUTA). Your FUTA obligation begins when you pay $1,000 or more in cash wages to household employees in any calendar quarter of the current or past year. Employees have no FUTA obligation.

Contact us with your questions about the "nanny tax." ■

* There are no FICA tax requirements for babysitters who are under age 18 *if* child care is not their principal occupation.

Tax Benefits of Net Operating Losses

Most businesses have good years and bad years. However, with proper planning, even a bad year can be helpful from a tax perspective. Where business deductions exceed gross income, a taxpayer may have a net operating loss (NOL) that can be used to offset income in another tax year, potentially generating a refund of previously paid taxes.

Eligibility

NOLs are available to individual business owners, corporations, estates, trusts, and charitable organizations with unrelated business income tax. Partnerships and S corporations do not take NOL deductions, though their partners and shareholders may use "pass-through" losses on their own returns.

Operation

The general rule is that a taxpayer may carry an NOL back two years and forward 20 years, though certain limited exceptions may apply. For example, an individual with an NOL that was caused by a casualty, theft, or disaster may use a three-year carryback period.

In general, the taxpayer will carry back an NOL to the earliest year it can be used and then carry it forward, year by year, until it is used up. The taxpayer may also elect to forego the two-year carryback and carry the loss forward for the 20-year period. However, the general preference is to use an NOL sooner rather than later, because a dollar of tax saved today is generally worth more than a dollar saved in the future.

Calculation

Calculations of NOLs can be complicated. For example, a noncorporate taxpayer's NOL is calculated without regard to any personal exemptions or NOLs from other years, and certain deductions for capital losses and nonbusiness items are limited. ■

Deducting a Casualty Loss

It seems like almost every day the news is filled with stories of people losing their property and even their entire homes to hurricanes, tornadoes, fires, and winter storms. If you have suffered a property loss, you may be able to claim a "casualty loss" tax deduction.

What Qualifies as a Casualty?

A "casualty" is the destruction of property from some sudden, unexpected, or unusual event. Examples include fires, storms, and car accidents. Progressive deterioration — for example, from termite infestation or a slow furnace leak — does not qualify. Neither does a mere decline in value.

The deduction is available only for physical damage or loss to your own property. For example, if you are in a car accident and pay for damage done to the other driver's car, the cost does not qualify. Likewise, if you're injured in the accident, your unreimbursed medical expenses do not qualify as a casualty loss (though they may count toward a medical expense deduction).

Personal Property

If your destroyed property was held for personal (nonbusiness) use, your casualty loss will be *the lesser of* (1) the decline in the property's value or (2) your basis in the property (usually, its cost). This calculated loss must be further reduced by any salvage value or insurance proceeds received.

Generally, two additional tax rules apply before you can take the deduction. First, the loss must be reduced by a $100 "floor." Second, the deduction is allowable only to the extent it (combined with any other casualty losses) exceeds 10% of your adjusted gross income (AGI).

Example. Kyrie's AGI is $90,000. A storm blows a tree down causing $30,000 of damage to her house, which she purchased for $250,000. The insurance company gave her $20,000 for the loss. To begin calculating her deduction, Kyrie takes the lesser of her basis ($250,000) and the cost of the damage ($30,000). After making a reduction for the insurance payment and the $100 "floor," Kyrie has a potential $9,900 deduction. However, the deduction is limited to the amount that exceeds 10% of her AGI ($9,000), so her casualty loss deduction will be $900.

To take a casualty loss deduction for personal property, you must itemize your deductions on Schedule A and complete Form 4684, *Casualties and Thefts.*

Business Property

Similarly, for trade or business property, the amount of the casualty loss is equal to the lesser of (1) the property's adjusted basis or (2) its decline in value. However, if the property is *totally destroyed,* the amount of the loss is equal to the property's adjusted basis. This rule prevents a business from taking a casualty loss deduction for more than the depreciated value of the property.

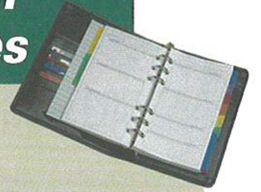
The two additional limitations that apply to casualty losses for *personal property* — requiring that the deductible loss exceed both a $100 "floor" and 10% of AGI — do not apply in the case of casualty losses to business property.

If property is held partly for personal and partly for business use, it must be treated as two separate properties, and the loss must be allocated appropriately.

Federally Declared Disasters

If the property was damaged as the result of a federally declared disaster, you may elect to deduct the loss in the tax year *before* the loss was incurred. Making the election may enable you to secure a tax refund earlier. ■

Calendar of Filing Dates



MAY

1 Employers: File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due for those who meet the safe harbor requirements.

10 Employers: Deferred due date for Form 941, if timely deposits were made.

15 Exempt organizations: File 2016 Form 990, 990-EZ, or 990-N, if the organization reports on a calendar-year basis.

15 Partnerships and S Corporations: If an election to use a tax year other than a required tax year was made, file Form 8752 to report the required payment.

JUNE

15 Individuals: Second installment of 2017 estimated tax due.

15 Corporations: Deposit second installment of estimated income tax for 2017, if the organization reports on a calendar-year basis.

JULY

31 Employee Benefit Plan Sponsors: File 2016 Form 5500 Annual Return/Report of Employee Benefit Plan. If your plan is not a calendar-year plan, file the form by the end of the seventh month after the plan year ends.

31 Employers: File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

Renting Out a Former Residence

Homeowners on the move sometimes decide to convert their principal residences into rental properties. Renting out a former home can be especially appealing when it can't be sold for an attractive price due to market conditions or when substantial future appreciation is anticipated. What are the potential tax effects?

Rental income and expenses. These amounts are reported on the owner's income tax return. Deductible expenses include money spent on advertising, cleaning and maintenance, insurance, mortgage interest, real estate taxes, repairs, and utilities, as well as depreciation (a noncash item). Even if a rental property is "paying for itself," it may show a tax loss for the year because of depreciation.

Passive activity losses. Your ability to currently use rental loss deductions may be limited by the tax law's passive activity (PAL) rules. However, a popular exception is available to individuals who own at least a 10% ownership interest in the property and "actively participate" in the rental activity. In this situation, up to $25,000 of passive rental losses may be used to offset nonpassive income, such as wages from a job. (The $25,000 loss allowance phases out with modified adjusted gross income, or MAGI, between $100,000 and $150,000.)

Sale of the property. Capital gain realized on the sale of a residence that has been converted into a rental property generally will be taxable. However, you *might* be able to exclude capital gain (within limits) if you sell the home while you still meet the conditions for excluding home sale gain. (To qualify for an exclusion, you generally must have owned and used the home as your principal residence for at least two of the five years preceding the sale.) Even then, a portion of the gain would be taxable (due to tax rules related to allowable depreciation and periods of nonqualified use).

If you are thinking of converting your residence to a rental property, contact us to discuss the tax implications. ■

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