# tax report

JULY 2017

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## Telecommuting Employees: Are Your Home Office Expenses Deductible?

If you are an employee who telecommutes, you may be eligible to deduct some of your home office expenses. But you must first comply with certain rules.

### Employer's Convenience

The first requirement is that your use of the home office be for the convenience of your employer. You may be able to satisfy this test if your employer requires you to have a home office and to work there, if the home office is necessary for the operation of your employer's business, or if the home office allows you to perform your work duties properly. You will not be able to satisfy this requirement if the home office is for *your own* convenience.

### Business Use

The next step is to look at your use of the space. Generally, the office must be the *principal* place of business for your work as an employee.

Even if the office is not your principal place of business, a deduction may be available if you use the office space as a place to meet with patients, clients, or customers of your employer. An office in an unattached structure on the same property as your home and used in connection with your work may also qualify.

### Exclusive and Regular Use

Last, you must use the space *exclusively and regularly* as your home office. The rule requires that the space be used as your home office *only*. However, the area doesn't need to be a separate room — it may be a portion of a room, provided it otherwise meets the relevant tests.

### Calculating the Deduction

There are two potential ways to calculate the amount of your home office expenses: the "actual expense" method or the "simplified" method. The actual expense method generally involves dividing various expenses of operating your entire home between personal and business use and claiming for deduction only those expenses that pertain to your home office. The simplified method entails taking the square footage of the home office (up to 300 square feet) and multiplying it by $5.

An employee's unreimbursed home office expenses are taken as an itemized "miscellaneous expense" deduction. They are therefore deductible only to the extent that they, when combined with other miscellaneous expenses, exceed 2% of your adjusted gross income. ■

## S Corp Shareholders

An S corporation must observe certain requirements to preserve its status as an S corporation. These include having only one class of stock and no more than 100 shareholders at any time. In addition, each shareholder generally must fall within specifically defined categories:

- Individual U.S. citizens or residents
- Decedents' estates
- Bankruptcy estates
- Certain tax-exempt charitable organizations
- Specific types of domestic trusts (grantor trusts, voting trusts, certain testamentary trusts, Qualified Subchapter S trusts (QSSTs), electing small business trusts (ESBTs), and tax-exempt qualified retirement plan trusts)

Transfer of shares to an ineligible shareholder will cause the S corporation to automatically lose its eligibility. As a precaution, provisions in the corporation's charter, bylaws, and/or the individual shareholder agreements will typically prohibit transfers to ineligible entities.

## short takes

### Medical Expense Deduction for Home Improvements

Potentially deductible medical expenses include expenses incurred to make permanent home improvements for the primary purpose of providing medical care for you, your spouse, or your dependent. Although the deductible amount is reduced by any amount by which the improvement increases the value of the property, the IRS presumes that certain improvements do *not* increase the value of the residence. These include entrance ramps, widened doorways, support railings installed in bathrooms, etc. Deductible medical expenses are subject to a deductibility threshold equal to 10% of adjusted gross income.

### Depreciation Limits on Autos, Light Trucks, and Vans

The IRS has announced the depreciation limits for business automobiles, light trucks, and vans first placed in service in 2017. Four sets of limits apply — two sets for passenger autos and two for light trucks and vans. For 2017, the limits are as follows: autos — $3,160 (first year of service); $5,100 (second year); $3,050 (third year); and $1,875 (each succeeding year). The respective limits for light trucks and vans are $3,560, $5,700, $3,450, and $2,075. Where the auto, van, or truck is eligible for bonus depreciation, the limit that applies to the first year of service (2017) is increased by $8,000.

*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.*

# Hiring Your Child for the Summer

If you own your own business, you might want to consider employing your child for the summer. Not only will your child have the opportunity to learn some valuable workplace skills, but you might be able to reduce your taxes as well.

### Potential Tax Savings

The wages you pay your child can qualify as a deduction from your business income, which would otherwise be taxed at your own rates. In addition, your child would be able to offset the wage income with his or her own standard deduction ($6,350 in 2017) and then have the rest taxed at his or her potentially lower rates. For 2017, a 10% rate applies to a single individual's taxable income of $9,325 or less.

### Requirements

For your child's wages to be deductible, the work must be done in connection with your trade or business, and the services your child performs must be reasonable in relation to the wages paid. You should be able to document that the usual conditions of employment — duties, regular hours, and wages — were agreed on and adhered to just as with any other employee.

### Another Possible Advantage

If you are a sole proprietor — or operate a partnership with only your spouse — wages paid to your child would be exempt from Social Security and Medicare (FICA) taxes until your child turns 18 and from federal unemployment taxes until age 21. ■

# Deducting Mortgage Refinancing Costs

Many homeowners are considering refinancing their home mortgages before rates increase further. Following are some of the general tax rules for deducting the charges associated with refinancing.

### Interest

Interest on a refinanced loan will be deductible to the extent the loan refinances up to $1 million of *home acquisition debt,* plus up to $100,000 of *home equity debt* (limits are $500,000/ $50,000 for married taxpayers filing separately). Home acquisition debt is a mortgage loan used to buy, build, or substantially improve a first or second home. Home equity debt is generally any other debt secured by a first or second home.

These limits, however, operate separately. For example, if a couple had $500,000 remaining in principal on their original mortgage loan and then refinanced that debt with a new $750,000 mortgage, they would be able to deduct the interest on only $600,000 ($500,000 plus $100,000). Interest on the remaining $150,000 would be nondeductible because it exceeds the combined limits.

### Points

Points paid for the refinancing of a loan that does not exceed these limits are deductible over the life of the loan. Any points paid in connection with the portion of a mortgage used to finance home improvements may be deductible in the year of the refinancing.

### Penalties and Fees

Generally, a prepayment fee paid on the old mortgage is considered a payment of interest on that mortgage and, therefore, is deductible in the year it is paid.

However, other fees, such as those for credit reports, appraisals, and loan origination, are not deductible. ■

# Small Business Retirement Plans

Whether you've recently started a business or have been operating one for some time, setting up a retirement plan can be beneficial to both you and your employees. Besides providing strong tax incentives to defer income and save for retirement, retirement plans can help you reward and retain employees. Employer contributions are tax deductible, within certain limits.

### SEP Plans

A Simplified Employee Pension (SEP) plan is relatively easy and inexpensive to set up and administer. You have complete discretion in determining whether or not to make annual contributions. To set up a SEP plan, you establish SEP individual retirement accounts (IRAs) for yourself and your employees. Qualifying contributions are tax deductible and not included in the employees' current income. Taxes are deferred until money is withdrawn from the plan.

The maximum amount of your contribution for each employee is the lesser of 25% of annual compensation or $54,000, and no more than $270,000 of compensation may be considered (for 2017). There is a special computation for figuring the maximum contribution to a self-employed individual's own SEP account. Additionally, contributions may not discriminate in favor of highly compensated employees.

### Solo 401(k) Plans

A solo 401(k) plan may be a suitable option if you work alone or employ only your spouse. The chief advantage of a solo 401(k) plan is that it allows you to save as both the employee and the employer. As an employee, you may defer the first $18,000 of your compensation (or $24,000 if you're age 50 or older). As the employer, you may also make a profit sharing contribution (subject to tax law limits). The combination of all contributions — including deferrals, profit sharing, and any others — may not exceed the lesser of (1) 100% of your compensation or (2) $54,000 ($60,000 if you're age 50 or older). Contribution limits are adjusted for inflation annually.

### SIMPLE IRAs

Like a SEP, a Savings Incentive Match Plan for Employees (SIMPLE) IRA plan entails setting up IRAs for yourself and each participating employee. You and your employees can elect to defer compensation to the plan (no more than $12,500 in 2017; $15,500 if age 50 or older). Additionally, employers must make an annual contribution by either (1) matching employee contributions up to 3% of pay (a lower 1% match is allowed in certain years) or (2) contributing 2% of pay for each employee who's eligible to contribute, even if the employee chooses not to contribute.

A SIMPLE plan generally isn't an option if you have another retirement plan or more than 100 employees.

### Defined Benefit Plans

The chief advantage of a defined benefit plan is the high deduction ceiling, which allows owners to rapidly build up their retirement benefits. For 2017, deductible contributions may allow for an annual benefit that will, when the participant reaches 65, equal the lesser of $215,000 per year or 100% of the participant's average compensation for his or her three highest consecutive years of active plan participation.

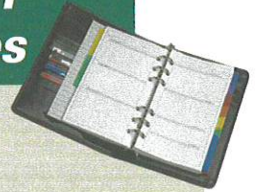
The disadvantages of this type of plan include the funding and administrative requirements. Complicated actuarial formulas must be used to calculate the contributions to be made each year.

### Tax Credit To Start a Plan

Eligible small employers that set up a new retirement plan may claim a credit of as much as $500 for each of the first three plan years. The credit can help defray plan start-up and employee retirement-related education costs. All of the plans mentioned above can qualify.

We would be happy to review your retirement plan options with you and help you choose a suitable plan. ■

## Calendar of Filing Dates



### 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.

### AUGUST

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

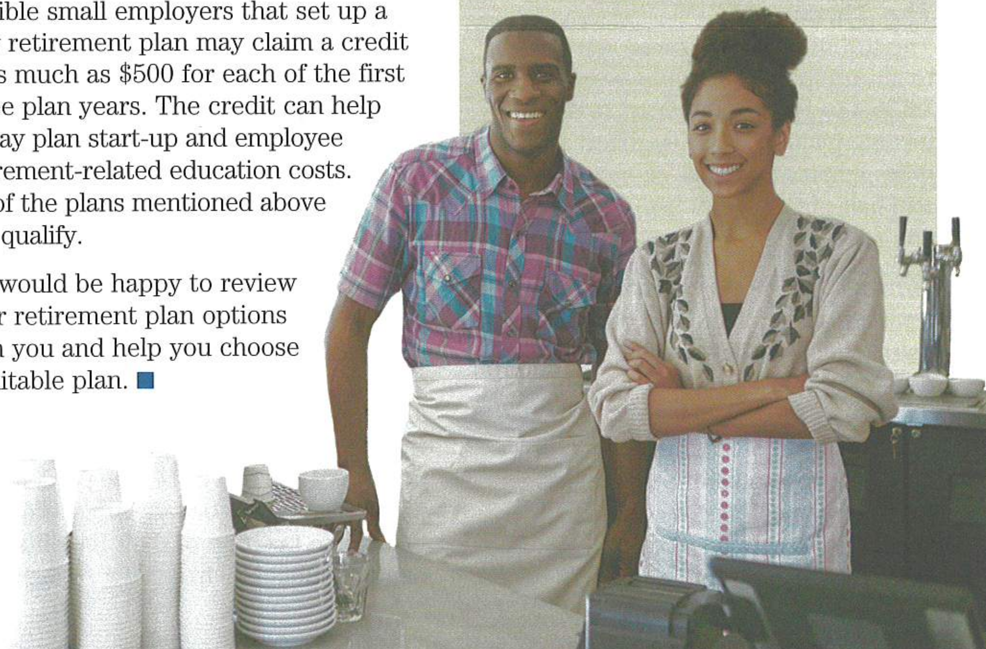
### SEPTEMBER

**15 Individuals:** Third installment of 2017 estimated tax due; file Form 1040-ES.

**15 Partnerships:** Last day for filing 2016 return (Form 1065) by a calendar-year partnership that obtained a six-month extension.

**15 S Corporations:** Last day for filing 2016 income tax return (Form 1120S) by a calendar-year S corporation that obtained an automatic six-month filing extension.

**15 Corporations:** Due date for depositing the third installment of estimated income tax for 2017 for calendar-year corporations.



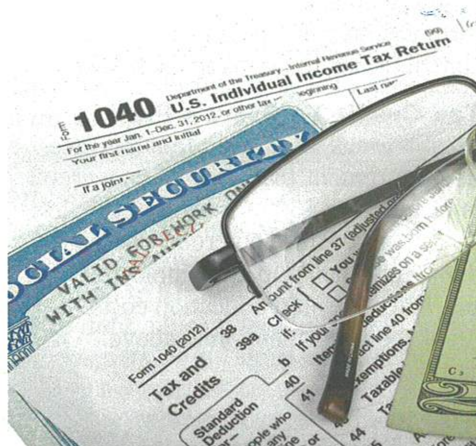
# Taxation of Social Security Benefits

If your income exceeds certain tax law thresholds, a portion of your Social Security retirement benefits will be subject to federal income taxes. Here's an overview.

## The Thresholds

The IRS uses your "provisional income" to determine the percentage of benefits subject to tax. Generally, provisional income includes your modified adjusted gross income *plus* tax-exempt interest and half of the Social Security benefits you received during the year.

Individuals with provisional income between $25,000 and $34,000 and married couples (filing jointly) with provisional income between $32,000 and $44,000 are taxed on up to 50% of their benefits. And up to 85% of benefits are taxable for individuals with provisional income over $34,000 and married couples with provisional income over $44,000.




Because these thresholds are not inflation-adjusted, more taxpayers tend to be affected as overall income levels increase. Government research projects that between 1998 and 2014, the percentage of Social Security beneficiaries affected by income taxation of their benefits nearly doubled — from 26% to 49%.*

## Minimizing the Tax Bite

If you are collecting Social Security, certain actions, such as taking a large retirement account distribution or recognizing capital gain from the sale of a second home, could push your provisional income past a threshold and/or increase your overall tax rate.

To help lessen the impact of taxes on your benefits, you might consider:

- Structuring a vacation home sale or traditional individual retirement account distribution so that income is received over more than one year.
- Liquidating assets in a taxable investment account rather than a retirement account if it will mean recognizing only a small capital gain rather than a larger addition to gross income. ■

* *Social Security: Calculation and History of Taxing Benefits,* Congressional Research Service, October 2016

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