

tax report

SEPTEMBER 2017

Recordkeeping Matters

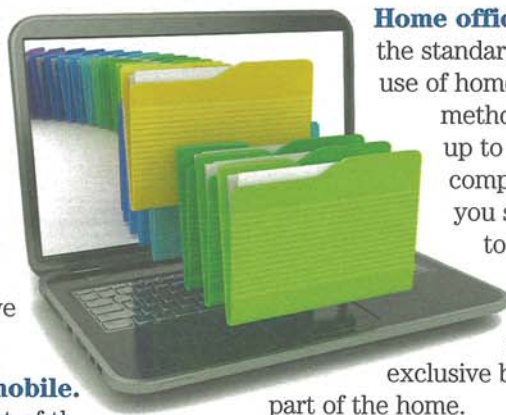
It's important to have appropriate records substantiating the deductions claimed on your income tax return. Here is an overview of the general IRS requirements for various types of expenses.

Business travel, meals and entertainment, and transportation. Generally, you must retain documentation to establish the amount, date, place, and business purpose for each expenditure. Specific expense categories may have additional requirements.

Business use of an automobile. Maintain records for the cost of the car and any improvements; the date you started using it for business; the mileage, destination, and business purpose for each trip; and the total mileage for the year. When you use the actual expense method rather than the IRS standard mileage rate (53.5 cents per mile for 2017), you also need records of your operating costs, such as gas, oil, repairs, maintenance, and insurance.

Charitable contributions. Cash contributions of less than \$250 require a bank record or written communication from the organization indicating the date and amount of the contribution. For noncash donations, you need a receipt and a record showing the donee's name and a description of the gift. If the value of any gift equals \$250 or more, you also need a contemporaneous written acknowledgment, a statement of whether the charity provided any

goods or services in exchange for the gift, and, if so, a description and a good faith estimate of the value. Additional rules apply to contributions of noncash property of more than \$500.



Home office. Whether you use the standard method (proportional use of home) or the simplified method (\$5 per square foot, up to 300 square feet) for computing the deduction, you should be prepared to produce records that substantiate your claimed expenses and show regular and exclusive business use of that part of the home.

Divorce. Alimony payments are tax deductible, but payments for child support are not. Taxpayers should retain their final divorce decree and any agreements for child support and/or separate maintenance in case the IRS questions claimed deductions. Any agreements regarding who will claim exemptions for dependent children also should be kept on file.

Hobbies. Deductions for hobby expenses are strictly limited. If you wish to claim the full extent of any expenses, you must be prepared to show that your activity qualifies as a business. Generally, the IRS will presume an activity is a business if you can show a profit in three of the past five years. If that isn't the case, then you should be prepared to produce evidence to satisfy a number of more subjective tests to avoid application of the tax law's "hobby loss" restrictions. ■



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Accountable Plan Advantages

Employers that reimburse their employees for business-related expenses should consider the potential tax advantages of having an "accountable plan." If all requirements are met, expense reimbursements are not included in an employee's wages and are not subject to either federal income or employment taxes. Here are the general requirements:

Each expense reimbursed under an accountable plan must have a "business connection," meaning the expense must be allowable as a deduction and paid or incurred by the employee while performing services as an employee.

Additionally, employees must adequately account for their expenses *and* return any excess reimbursements or allowances within a reasonable period of time. What is reasonable will depend on the facts and circumstances, but the IRS has provided a safe harbor rule allowing substantiation of an expense within 60 days after it is paid or incurred and the return of an advance within 120 days.

short takes

New HSA Numbers

The IRS has announced the health savings account (HSA) limits for 2018. Generally, eligible individuals covered by a high-deductible health plan (HDHP) and no other health plan (with limited exceptions) may use an HSA to set aside funds for future medical needs. Contributions to an HSA are tax deductible (within limits), and distributions are tax exempt when used for qualifying out-of-pocket medical expenses. For 2018, a qualifying HDHP must have an annual deductible of at least \$1,350 for self-only coverage or \$2,700 for family coverage. Additionally, annual out-of-pocket expenses may not exceed \$6,650 for self-only coverage or \$13,300 for family coverage. HSA contribution limits will be \$3,450 for a person with self-only coverage and \$6,900 for a person with family coverage.

Retirement Plans and Savings Rates

According to survey results published by the Investment Company Institute, 70% of U.S. households had favorable impressions of 401(k) and similar defined contribution (DC) retirement plans. Nine out of 10 households with DC accounts agreed that such plans helped them think about long-term saving needs, with more than two thirds indicating that saving paycheck by paycheck made them less worried about the stock market. Additionally, eight in 10 households with DC plans said the tax treatment of their retirement plans was a big incentive to contribute.

ICI, *American Views on Defined Contribution Plan Saving*, 2016, February 2017

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.

Tax Breaks for Elder Care

Caring for an elderly parent or relative can be costly. However, several tax provisions are available to help caregivers recover some of their expenses.

Dependency Exemption

Generally, you may claim a dependency exemption (\$4,050 in 2017) for an individual if you provide more than 50% of the individual's support costs *and* the individual:

- Lives with you *or* is related to you
- Does not have gross income exceeding the exemption amount
- Does not file a joint return
- Is a U.S. citizen or a resident of the U.S., Canada, or Mexico

The exemption is phased out for higher income taxpayers.



Medical Expenses

If you pay medical expenses for your dependent parent (or other dependent relative), you may include those expenses with your own for tax deduction purposes.* The deduction may also be available if your parent or relative fails to qualify as your dependent because of the gross income and/or the joint return test listed above. Medical expenses include the qualifying long-term care costs of a chronically ill individual.

Dependent Care Credit

Additionally, you may be entitled to a tax credit for a portion of any costs you incur for care of your parent or relative that enables you (and your spouse, if married filing jointly) to work. Your parent or relative must live with you and be unable to care for himself or herself. ■

* Medical expenses are deductible to the extent they exceed 10% of your adjusted gross income.

Estate Executors: Be Aware of Tax-filing Requirements

The executor (or personal representative) of an estate has many responsibilities. Among them: the timely filing of applicable tax returns. Here's a brief rundown of the federal tax returns that may be required. (States have different filing requirements.)

Final Income Tax Return

Nearly all estates must file a final federal income tax return for the decedent. Because most individual taxpayers file on a calendar-year basis, the final tax year will typically cover the period from January 1 through the date of death. The final return (Form 1040) is generally due on April 15 of the year following the date of death. An automatic six-month extension may be obtained by filing Form 4868.

Estate Income Tax Return

Additionally, one or more estate income tax returns may have to be filed. Generally, the executor is required to file an income tax return (Form 1041) for the

estate for each tax year in which the estate has gross income of \$600 or more. He or she may elect either a calendar or a fiscal year. This decision is an important one because, in some cases, the executor may obtain additional tax deferral for a beneficiary by electing a fiscal year that ends after the close of the beneficiary's taxable year.

Estate Tax Return

Because the exclusion amount is high — \$5.49 million for 2017 — many estates will not owe any federal estate tax. However, if the decedent has a surviving spouse, the executor may want to file an estate tax return anyway. The reason: The tax law allows a married person's executor to make an election on the estate tax return to pass the deceased spouse's unused exclusion amount to the surviving spouse for eventual use on his or her own estate tax return. Absent this "portability" election, the benefit of the unused exclusion would be lost. ■

A Costly Penalty

The cash crunch — when money goes out faster than it comes in — is a problem almost every business faces at one time or another. Employers that may be tempted to pay overdue bills before they deposit withheld income and employment taxes should consider the severe penalty that may apply.

The IRS can hold “responsible persons” liable for up to 100% of any such unpaid taxes by imposing the “trust fund recovery penalty” (TFRP). Following is an overview.

Background

Employers are required to withhold federal income and FICA (Social Security and Medicare) taxes from their employees’ pay and to remit those taxes to the government on a set schedule. To ensure that these taxes are promptly turned over to the IRS, federal law deems these taxes to be held “in trust” for the federal government until paid over.

Moreover, the tax law provides that the “willful failure” of a responsible person to collect or account for and pay over these taxes can result in imposition of a penalty equal to 100% of the unpaid amount. This penalty — the TFRP — is frequently used by the IRS to enforce its right to collect unpaid trust fund taxes.

Who Is a Responsible Person?

A responsible person may include an officer, director, shareholder, or employee of the corporation, as well as a partner or employee of a partnership, who is under a duty to collect and/or pay these taxes. Even a voluntary board member of a tax-exempt organization may be subject to the penalty in certain circumstances. Also potentially liable are third-party payers, such as payroll service providers.

Because a responsible person includes a person or group of people with the duty to perform and the power to direct the collecting, accounting, and payment of trust fund taxes, such persons would generally not include an employee who lacks discretionary authority to determine who is paid.

Though there is often more than one responsible person in a business, each is potentially liable for the entire penalty.

However, responsible persons who pay more than their proportionate share of the penalty have the right to recover the excess from other responsible persons.

“Willfulness”

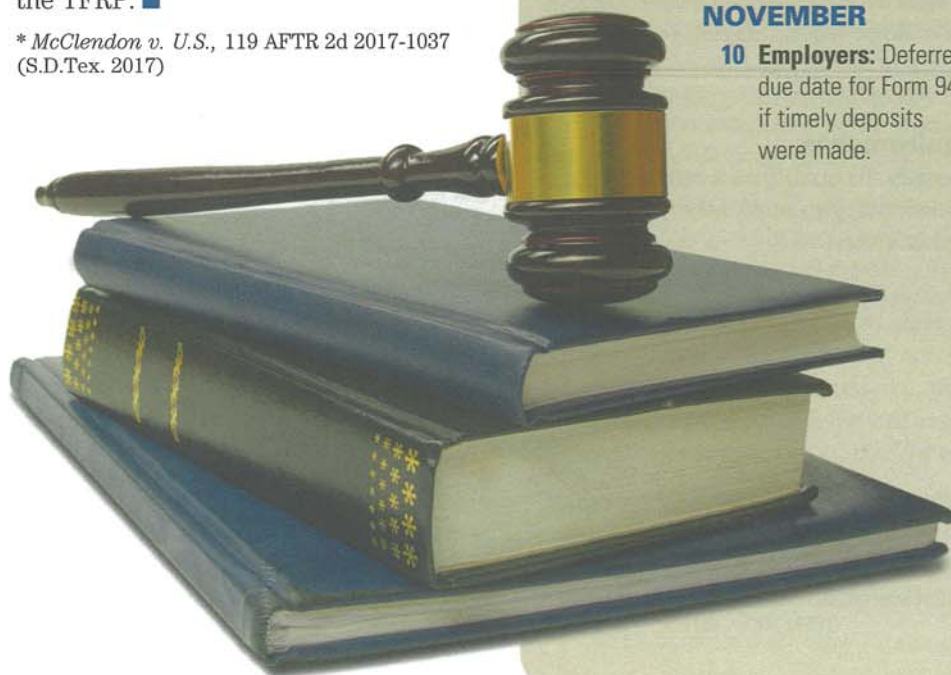
Typically, a willful failure is demonstrated where the responsible person intentionally gives preference to one creditor over another. For example, in a recent case, the owner of a medical practice learned that his chief financial officer’s embezzlement had caused the practice to incur over \$10 million in unpaid payroll and other withholding taxes.* The owner closed the practice and remitted all remaining receivables to the IRS. He also loaned \$100,000 to the practice for the specific purpose of paying the upcoming payroll. Despite the owner’s good intentions, the court held that payment of that amount to the creditors/employees — rather than the IRS — justified a finding of willfulness.

Avoiding the TFRP

Employers can avoid the TFRP by making sure that all employment taxes are collected, accounted for, and paid to the IRS in a timely manner. Under no circumstances should an employer fail to observe its withholding obligations or “borrow” from the account to meet other obligations.

Contact us if we can answer any additional questions you might have about the TFRP. ■

* *McClendon v. U.S.*, 119 AFTR 2d 2017-1037 (S.D.Tex. 2017)



Calendar of Filing Dates



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.

OCTOBER

- 16 Individuals:** File 2016 federal income tax return and pay any tax due if you obtained a six-month filing extension.
- 16 C corporations:** Last day for filing 2016 income tax return (Form 1120) by a calendar-year C corporation that obtained an automatic six-month extension.
- 31 Employers:** File Form 941, Employer’s Quarterly Federal Tax Return, for the third quarter of 2017.

NOVEMBER

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

Real Estate Professionals and Rental Losses

Owners of rental properties that show a tax loss must address the tax law's "passive loss" limitations, meaning that the rental losses are not currently deductible against nonpassive income, such as salary. However, qualifying real estate professionals may be able to make use of an exception to this general rule.

Requirements

Generally, to qualify as a real estate professional, you must satisfy three requirements:

First, you must demonstrate that you materially participate in a real estate business. "Material participation" means regular, continuous, and substantial participation. IRS regulations contain seven tests for establishing material participation.

Second, more than 50% of the personal services you perform in all businesses during the year must be performed in real estate businesses in which you

materially participate. As a result, you need not work full-time in real estate to qualify as a real estate professional.

Third, the time spent on the real estate activities must total more than 750 hours during the year. You may not count any work you perform in your capacity as an investor.

Separate Properties

Each rental property is separately evaluated for material participation unless you make an election to treat all rental real estate activities as one activity. However, this decision should be made carefully, because once made, it is generally irrevocable.

Recordkeeping

You will want to keep records that establish the extent of your material participation in your real estate business activities. Your records might include appointment books, calendars, daily time



reports, or similar documents that you keep contemporaneously. Be sure to provide details regarding what you did, when you did it, and how long it took you.

Please contact us if you would like to discuss your situation. ■