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2017

NEW DEVELOPMENTS
Long Format

UPDATED November 1, 2017

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2017 NEW DEVELOPMENTS LETTER

INTRODUCTION

For months President Trump and Republican Congressional leaders have been calling for major tax reform. Finally, on November 2, 2017, the House Ways and Means Committee released its initial draft of proposed Tax Reform legislation, which kicks off the legislative process between the House and the Senate in their attempt to pass a single tax reform bill that President Trump can sign into law. We have included in this letter a general overview of key provisions in this recently-released proposed legislation. Caution! The status of this legislation continues to be fluid, and it is not possible to predict with precision what changes will be included in any *"final"* tax bill, when it will be passed, or even whether final tax reform legislation will be passed at all. Moreover, as the proposed legislation works its way through Congress, it is likely that new proposals will be added and certain current proposals will be modified or even eliminated altogether. We are ***closely monitoring all proposed tax legislation*** in Congress, so ***feel free to call our firm*** if you need a ***status report.***

Although recent Press coverage has been dominated by tax reform proposals, we should not overlook other ***Major Tax Developments*** that have occurred during 2017 resulting from: ***Recent Targeted Tax Legislation*** that has been enacted; ***Recent Court Cases*** addressing various tax issues; and Various ***Recently-Released IRS*** regulations, rulings, and announcements. Keeping up with these fast-paced developments is challenging! Consequently, in addition to providing a general overview of the recent proposed tax legislation, this letter provides highlights of other tax developments that we believe will have the greatest impact on our clients.

This letter only highlights *selected* tax developments. If you have heard about other tax developments not discussed in this letter, and you need more information, please call our office for details. Also, ***we suggest that you call our firm before implementing any tax planning technique discussed in this letter.*** You cannot properly evaluate a particular planning strategy without calculating your overall tax liability (including the alternative minimum tax and any state income tax) with and without that strategy. This letter contains ideas for Federal income tax planning only. ***State income tax issues are not addressed.***

TABLE OF CONTENTS

A Table of Contents begins on the next page to help you locate items of interest.

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TABLE OF CONTENTS

DEVELOPMENTS IMPACTING PRIMARILY INDIVIDUALS 1

PROPOSED TAX REFORM LEGISLATION RELEASED NOVEMBER 2, 2017 - GENERAL OVERVIEW 1

LOWER TAX RATES 1

INCREASED STANDARD DEDUCTION AND THE ELIMINATION OF PERSONAL AND DEPENDANCY EXEMPTIONS 1

TARGETED FAMILY TAX CREDITS 1

REPEAL OF CERTAIN DEDUCTIONS AND CREDITS 1

CERTAIN DEDUCTIONS WOULD BE RETAINED 1

EDUCATION TAX RELIEF PROVISIONS 1

EXCLUSIONS FOR HOME-SALE GAINS 1

ELIMINATION OF THE ALTERNATIVE MINIMUM TAX AND ESTATE TAX 2

LEGISLATIVE AND ADMINISTRATIVE TAX RELIEF FOR HURRICANE VICTIMS 2

RECENT COURT CASES 2

RECENT TAX COURT CASES CONFIRM THAT A NON-QUALIFYING TAXPAYER IS REQUIRED TO PAY BACK ADVANCE PREMIUM TAX CREDIT PAYMENTS 2

NEW CASE MAY PROVIDE OPPORTUNITY FOR SINGERS, ACTORS, ATHLETES, AND OTHER ENTERTAINERS TO DEDUCT 100% (INSTEAD OF 50%) OF BUSINESS MEALS WHILE ON THE ROAD 2

PRO-TAXPAYER TAX COURT CASE MAY PROVIDE RELIEF FOR CERTAIN REVERSE LIKE-KIND EXCHANGES THAT FAIL THE IRS SAFE HARBOR PROCEDURES 3

RECENT CASES ANALYZE WHETHER THE COSTS OF AN MBA QUALIFY FOR A BUSINESS DEDUCTION 3

RECENT CASES ILLUSTRATE HOW EASY IT IS FOR A TAXPAYER TO LOSE THE DEDUCTION FOR ALIMONY-TYPE PAYMENTS 4

RECENT COURT CASES HOLD THAT TAXPAYERS MAY NOT OVERSTATE THEIR EARNED INCOME IN ORDER TO PRODUCE A LARGER REFUNDABLE EARNED INCOME CREDIT AND/OR CHILD TAX CREDIT 4

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RECENT IRS GUIDANCE 5

IRS WARNS THAT A DECEASED SPOUSE'S IRA PASSING TO A SURVIVING SPOUSE COULD GET CAUGHT UP IN THE "ONE-ROLLOVER-PER-YEAR" TRAP 5

PROPOSED REGULATIONS CLARIFY CERTAIN CHILD-RELATED TAX BENEFITS 5

NEW REPORTING REQUIREMENTS INVITE MORE IRS SCRUTINY AND PENALTY EXPOSURE FOR TAXPAYERS INVESTING IN CERTAIN SYNDICATED CONSERVATION EASEMENT ARRANGEMENTS 5

DEVELOPMENTS IMPACTING PRIMARILY BUSINESSES 6

PROPOSED TAX REFORM LEGISLATION RELEASED NOVEMBER 2, 2017 – GENERAL OVERVIEW 6

LOWER TAX RATES AND REPEAL OF AMT FOR REGULAR CORPORATIONS 6

LOWER TAXES ON "SMALL BUSINESSES" TAXED AS PASS-THROUGH ENTITIES 6

ENHANCED FIRST-YEAR 168(K) BONUS DEPRECIATION 6

INCREASE IN THE CAPS IMPOSED ON THE 179 DEDUCTION 6

SMALL BUSINESS RELIEF FOR ACCOUNTING METHODS 7

NEW LIMITATIONS ON LIKE-KIND EXCHANGES 7

RECENTLY-ENACTED LEGISLATION 7

CONGRESS AUTHORIZES A NEW OPTION FOR CERTAIN EMPLOYERS THAT ARE CONSIDERING A HEALTH REIMBURSEMENT ARRANGEMENT 7

RECENT COURT CASES 8

RECENT TAX COURT CASE REMINDS S CORPORATION SHAREHOLDERS THAT OBTAINING BASIS THROUGH LOANS CAN BE TRICKY 8

TAX COURT IDENTIFIES NEW TAX TRAP FOR ACCRUAL-METHOD S CORPORATIONS THAT SPONSOR ESOPS 8

RECENT CASES ADDRESS SELF-EMPLOYMENT TAX TREATMENT FOR OWNERS OF LIMITED LIABILITY COMPANIES (LLCS) 8

RECENT TAX COURT CASE ILLUSTRATES THAT POOR DOCUMENTATION MAY CAUSE "S" CORPORATION SHAREHOLDERS TO LOSE THEIR S/E TAX SAVINGS 9

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PERSONS WITH ANY AUTHORITY OVER COLLECTING, ACCOUNTING FOR, AND/OR PAYING AN EMPLOYER'S PAYROLL TAXES SHOULD MAKE SURE THAT ALL PAYROLL TAXES ARE ACTUALLY PAID TO THE IRS 10

RECENT IRS GUIDANCE 10

BUSINESSES USING EMPLOYEE LEASING COMPANIES (I.E., PROFESSIONAL EMPLOYER ORGANIZATIONS) MAY WANT TO CONSIDER USING PROFESSIONAL EMPLOYER ORGANIZATIONS THAT HAVE BEEN CERTIFIED BY THE IRS 10

IRS (AND COURTS) ARE SCRUTINIZING CERTAIN MICRO-CAPTIVE INSURANCE ARRANGEMENTS 11

IRS RELEASES ITS LATEST AUTOMATIC ACCOUNTING METHOD CHANGE PROCEDURE 11

IRS ISSUES HELPFUL GUIDANCE ON RECENT CHANGES TO THE 179 DEDUCTION AND FIRST-YEAR 168(K) BONUS DEPRECIATION 11

IRS ANNOUNCEMENT CREATES UNCERTAINTY AS TO WHEN A NEWLY-CONSTRUCTED RETAIL BUILDING OR IMPROVEMENT IS CONSIDERED "PLACED-IN-SERVICE" FOR PURPOSES OF DEPRECIATION AND THE 179 DEDUCTION 12

UPDATED IRS AUDIT GUIDE PROVIDES VALUABLE INSIGHTS ON HOW IRS AGENTS ARE INSTRUCTED TO REVIEW COST SEGREGATION STUDIES 13

FINAL COMMENTS 13

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DEVELOPMENTS IMPACTING PRIMARILY INDIVIDUALS

PROPOSED TAX REFORM LEGISLATION RELEASED NOVEMBER 2, 2017 – GENERAL OVERVIEW

As noted in the Introduction, on ***November 2, 2017,*** the House Ways and Means Committee released its initial proposed tax reform bill entitled ***"The Tax Cuts And Jobs Act of 2017"*** (the ***"Act"***). As this proposed legislation works its way through Congress, new proposals will likely be added and certain current proposals will be modified or even eliminated altogether. Moreover, it is still up in the air whether and when this tax reform legislation will actually be enacted. However, this initial bill provides us with the most detailed guidance to date regarding the types of tax changes Congress and President Trump will be debating. **Caution!** Over the upcoming weeks, there will likely be reports to the public of proposed tax changes that we do not discuss below. However, we closely monitor major proposed tax legislation in Congress, so feel free to call our firm if you have questions about proposals not discussed below or you simply need a status report.

The ***Act*** contains over 400 pages of detailed legislative proposals. It is well beyond the scope of this letter to provide a detailed discussion of this mammoth bill. Therefore, we highlight below only selected provisions in the ***Act*** that we believe, if enacted, could likely have a significant impact on ***"Individual"*** taxpayers.

Unless stated otherwise, the proposals listed below *would not be effective until 2018*!

Lower Tax Rates. The *Act* would generally reduce the current seven tax-rate brackets to four (12%, 25%, 35%, and 39.6%). The lowest 12% rate would apply to the first $90,000 of taxable income for joint filers ($45,000 for singles), and the top 39.6% rate would apply to taxable income exceeding $1,000,000 for joint filers (exceeding $500,000 for singles). The tax rate on long-term capital gains (and presumably qualified dividends) would generally be consistent with current law.

Increased Standard Deduction And The Elimination Of Personal And Dependancy Exemptions. The *Act* would eliminate the personal and dependancy exemptions altogether, and replace them with a much larger standard deduction ($24,400 for joint filers; $18,300 for unmarried individuals with a qualifying child; and $12,200 for singles).

Targeted Family Tax Credits. The *Act* would increase the child credit to $1,600 (up from the current $1,000) per qualifying child, and create a new $300 credit for each individual and each dependent of that individual (other than a qualifying child).

Repeal Of Certain Deductions And Credits. The *Act* would repeal the following deductions: State and local ***"income"*** tax; Personal casualty losses; Alimony; Medical expenses; Moving expenses; and, several others. The Act would also repeal several individual tax credits, including the *"Adoption Credit"* and the credit for *"Plug-in Electric"* cars.

Certain Deductions Would Be Retained. The *Act* would generally retain deductions for: Home mortgage interest (However, would lower loan amounts and make other changes for loans after November 2, 2017); State and local ***"property"*** tax (up to $10,000); and Charitable contributions.

Education Tax Relief Provisions. The *Act* would eliminate many of the tax break provisions for education costs, including: Student loan interest deduction; Life-Time Learning Credit; Deduction (up to $4,000) for qualified tuition; and several others. However, the *Act* would retain and expand: the *"American Opportunity Tax Credit,"* and tax-favored 529 College-Savings Plans.

Exclusions For Home-Sale Gains. Effective for ***sales or exchanges after 2017,*** the *Act* would make the following changes to the home-sale gain exclusion rules: **1)** Require an individual to own and use a home as the individual's principal residence for ***5 out of the previous 8 years*** (instead of 2 out of the previous 5 years) to qualify for the up to $500,000 or $250,000 home-sale exclusion, **2)** Allow the taxpayer to use the home-sale exclusion ***only once every five years*** (instead of once every two years as under current law), and **3)** ***Reduce the exclusion for*** each dollar of an individual's ***average AGI*** (average of the current and prior two years) ***in excess of $500,000*** ($250,000 for single filers).

Elimination Of The Alternative Minimum Tax And Estate Tax. The Act would repeal the *"Alternative Minimum Tax"* (AMT). It would also repeal the *Estate Tax* for ***individuals dying after 2023.*** The Gift Tax would be retained.

Caution! We have highlighted only *selected* tax changes contained in the *Act* that would impact individuals, there are many more changes in this mammoth tax bill! If you have heard about other proposed legislative tax changes not discussed above, and you need more information, please call our office.

LEGISLATIVE AND ADMINISTRATIVE TAX RELIEF FOR HURRICANE VICTIMS

On September 29, 2017, President Trump signed the ***"Disaster Tax Relief and Airport and Airway Extension Act of 2017"*** (*"Disaster Relief Act"*) providing temporary tax relief to victims of Hurricanes Harvey, Irma, and Maria. The IRS has also released a series of ***Announcements*** providing additional administrative relief for taxpayers impacted by the hurricanes. The relief generally applies to individuals and businesses located in Florida, Georgia, certain counties in Texas, certain counties in South Carolina, certain parishes in Louisiana, parts of Puerto Rico, and the Virgin Islands. In some situations, taxpayers not located in those disaster areas may qualify for relief (e.g., Where business records are located in the designated disaster areas; For taxpayers that own an interest in an S corporation or partnership with primary business operations in the designated disaster areas).

Tax relief under the *Disaster Relief Act* generally includes: Larger deductions for personal casualty losses; Expanded options to take tax-favored withdrawals or loans from retirement plans; Option of using current or prior year's income for purposes of claiming the earned income and child tax credits; New *"employee retention tax credit"* of 40% of up to $6,000 of *"qualified wages"* paid by certain affected employers; and Increased limitation for charitable contribution deductions for individuals and businesses making qualifying charitable contributions for Hurricane Disaster Relief.

Administrative relief granted by the IRS generally encourages leave-based donation programs for hurricane victims, and allows retirement plans to make hardship distributions. ***In addition,*** the IRS provides automatic extensions for various IRS deadlines. ***For example,*** the IRS has extended ***until January 31, 2018*** the deadlines for filing the following returns: Individual, corporate, and estate and trust income tax returns; partnership returns, S corporation returns, trust returns; estate, gift, and generation skipping transfer tax returns; annual information returns of tax exempt organizations; employment and excise tax returns (including payroll tax returns due October 31, 2017), and 5500s that were ***otherwise due***: **1)** On or after ***August 23, 2017*** for ***qualifying Texas taxpayers,*** **2)** On or after ***September 4, 2017 for Florida taxpayers,*** **3)** On or after ***September 6, 2017 for qualifying South Carolina taxpayers,*** and **4)** On or after ***September 7, 2017 for Georgia taxpayers.*** Caution! This automatic extension generally applies to ***individual filers*** with ***extensions of time to file until October 16, 2017,*** and to ***business returns*** with ***extensions until September 15, 2017.***

Planning Alert! These relief provisions are lengthy and detailed. Please call our firm if you think you, your business, or someone you know could benefit from this relief, and we will be glad to fill you in on the details.

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RECENT COURT CASES

Recent Tax Court Cases Confirm That A Non-Qualifying Taxpayer Is Required To Pay Back Advance Premium Tax Credit Payments. Two recent Tax Court cases held that a taxpayer who received ***Advance Premium Tax Credit*** (APTC) payments that were previously awarded by a State or Federal insurance exchange (Exchange), must repay the advance payments to the IRS if it is later determined that the taxpayer did not qualify for the *APTC* payments. Both decisions said that the fact the *Exchanges* were partially complicit in erroneously determining that the taxpayers qualified for the *APTC* payments did not change the taxpayer's obligation to pay back the improper *APTC* payments.

New Case May Provide Opportunity For Singers, Actors, Athletes, And Other Entertainers To Deduct 100% (Instead Of 50%) Of Business Meals While On The Road. Generally, the cost of meals while a taxpayer is *"away from home"* during qualifying business travel qualifies as a deductible business expense. However, subject to limited exceptions, only *"50%"* of the cost of qualifying business-related meals may be deducted. However, in a recent pro-taxpayer Tax Court case, the Court allowed the owners of the Boston Bruins NHL hockey team a *"100% deduction"* for meals provided to the players and to related traveling personnel for "*away games.*" The Court reached this conclusion only after determining that, under the specific facts of that case, the owners of the Boston Bruins satisfied several technical requirements that must be met in order to qualify for the 100% (instead of 50%) deduction. It is not yet clear what other types of business activities (beyond professional sports) could possibly benefit from the holding in this case. It has been suggested that the principles established in this case could possibly apply to traveling entertainers such as singers, entertainers, and actors. Some have even suggested that this Court decision might apply to out-of-town business travel by other professionals that requires the significant use of hotel facilities - such as speakers on professional topics. If you would like more details of this case and how it might possibly apply to a specific situation, feel free to contact our firm.

Pro-Taxpayer Tax Court Case May Provide Relief For Certain Reverse Like-Kind Exchanges That Fail The IRS Safe Harbor Procedures. When a like-kind exchange is structured, a qualified deferred like-kind exchange arrangement is most commonly used. A classic example of a qualified deferred like-kind exchange would typically involve a series of transactions similar to the following: **1)** Taxpayer signs a contract to sell a specific tract of real estate (the *"Relinquished Property"*), to be closed at a specified future date, **2)** Before the sale is closed, Taxpayer assigns the seller's obligations under the sales contract to a *"Qualified Third-Party-Intermediary"* (e.g., a qualified title company), **3)** The *Qualified Intermediary* later closes the sale of the *Relinquished Property*, and holds the sales proceeds, **4)** Within 45 days of the closing of the sale, the Taxpayer identifies the desired replacement real estate (the *"Replacement Property"*), and **5)** Within 180 days of the closing of the sale of the *Relinquished Property* (or by the due date of the taxpayer's tax return, if earlier), the *Qualified Intermediary* uses the sales proceeds from the previous sale of the *Relinquished Property* to purchase the *Replacement Property*, and then transfers the *Replacement Property* to the Taxpayer.

However, on occasion, taxpayers wanting to utilize a deferred like-kind exchange need to acquire the *"Replacement Property"* ***before*** selling their *"Relinquished Property."* These transactions are frequently referred to as *"reverse"* like-kind exchanges. For these situations, the IRS has issued Procedures that, if precisely followed by the taxpayer, will provide a safe harbor for structuring a *"reverse"* like-kind exchange (i.e., where the taxpayer acquires the *Replacement Property* ***"before"*** selling the *Relinquished Property)*. Following this safe harbor ensures that the IRS will not challenge the reverse like-kind exchange. In a recent Tax Court decision, the Court allowed a reverse like-kind exchange even though the taxpayer failed the requirements of the IRS's safe-harbor Procedures. In certain circumstances, this Case may give taxpayers judicial support for a *reverse* like-kind exchange that inadvertently (or unavoidably) fails the requirements of the IRS safe-harbor Procedures. **Caution!** The IRS recently announced that it does not agree with this Court's analysis or conclusion, and warns that it plans to continue contesting *"reverse"* like-kind exchanges that do

not comply with the IRS safe harbor procedure. Please call our firm if you need more details about this case, or if you would like more information on like-kind exchanges generally.

Recent Cases Analyze Whether The Costs Of An MBA Qualify For A Business Deduction. Over the last couple years, the IRS seems to be taking an increasing number of taxpayers to Court to determine whether an employee is entitled to an employee *"business"* deduction for *MBA-related* expenses. We have had at least two Tax Court cases addressing this issue this year alone. *In these cases*, consistent with previous cases, the Tax Court held that for a taxpayer to be allowed a business deduction for the costs of pursuing an MBA, the individual must establish that his or her course of study: **1)** *"Maintains and improves"* the skills needed in the individual's current line of work, and **2)** Does not prepare the individual for a *"new trade or business."* **In the first Case,** the Tax Court did allow a business deduction for MBA costs incurred by an employee who was a *"business manager/financial analyst"* (the Court held that the MBA program *"maintained and improved"* the individual's existing skills in his job, and did not qualify him for a new trade or business). ***In the second case,*** the Tax Court denied a business deduction for costs of an *"Executive MBA"* program incurred by *a "software engineer"* (the Court concluded that the program qualified her for a *"new"* trade or business). Whether or not a Court allows a business deduction for MBA costs is based largely on the specific facts of each case. If you have a specific situation that you want us to evaluate, please call our firm and we will gladly assist you. Planning Alert! If an employee incurs an unreimbursed education expense that ***qualifies as a business deduction***, the deduction will generally be subject to the 2% of AGI reduction that applies to *"unreimbursed employee business expenses."* However, if the employee's education expense is reimbursed under the employer's *"accountable reimbursement arrangement,"* the employer can fully deduct the reimbursement and exclude it from the employee's taxable income as a so-called *"working condition fringe."*

Recent Cases Illustrate How Easy It Is For A Taxpayer To Lose The Deduction For Alimony-Type Payments. In order for a divorced spouse to be able to deduct *"alimony,"* the payments must satisfy all of the technical requirements for tax-deductible alimony as outlined in the Internal Revenue Code (Code). For example, among other things, the Code requires that: the payments must be paid in ***cash or cash equivalent***; the payments must terminate no later than the ***death of the payee spouse***; the payments must be paid pursuant to a *Court order* or *written separation agreement* ***("divorce or separation instrument"***); and the *divorce or separation instrument* ***cannot designate*** the payments as ***"nondeductible"*** by the payor spouse and nontaxable to the payee spouse. The IRS has consistently taken the position that deductible *"alimony"* payments must ***"strictly comply"*** with each of these statutory requirements, and the Courts have largely agreed.

In recent years, the Courts have held that: **1)** A Court-approved *"lump-sum alimony"* payment that replaced an earlier Court-approved monthly alimony payment *was not deductible* as alimony because there was no requirement that the *"lump-sum alimony"* terminate at the death of the former spouse; **2)** Payments under an unsigned *"draft"* marital agreement *did not qualify* as deductible alimony because the unsigned *"draft"* did not constitute a "*written separation agreement*;" **3)** A transfer of *"real estate"* to satisfy a divorced individual's otherwise qualifying alimony obligation *did not qualify* for an alimony deduction because it was not paid in *cash or cash equivalent*; and **4)** The payor spouse's payment of 50% of his after-tax bonus to his former spouse was *not deductible* as alimony because the payment was not made pursuant to the terms of a *qualifying written separation agreement*.

In this past year, a recent private letter ruling and a recent Tax Court case each addressed whether the taxpayer satisfied the requirement that "*the divorce or separation instrument* ***must not designate*** *the payment as nondeductible by the payor spouse, and nontaxable to the payee spouse*." In both situations, the spouse making the payment lost the deduction. These two cases illustrate how poorly-drafted language in a divorce or separation instrument can cause the payor spouse to unexpectedly lose his or her deduction for alimony. Planning Alert! If you are involved in divorce

proceedings, anticipate making payments to your spouse, and are counting on a deduction for these payments - these cases illustrate that the agreement needs to be properly worded so that the payments meet each and every technical requirement for tax-deductible alimony. In addition, if the payments under the agreement meet the requirements for deductible alimony, it is important that you do not deviate from the specific payment requirements of the agreement.

Recent Court Cases Hold That Taxpayers May Not Overstate Their Earned Income In Order To Produce A Larger Refundable Earned Income Credit And/Or Child Tax Credit. Generally, the earned income credit (EIC) is *"refundable"* and in certain situations the Child Tax Credit (CTC) is also *"refundable*." This generally means that, to the extent that a *refundable* EIC and/or CTC exceeds the taxes that you would otherwise owe with your individual income tax return without the credit, the IRS will actually send you a check for the excess. In addition, in certain situations that generally apply to lower-income individuals, the amount of an individual's refundable EIC and/or CTC increases as the individual's taxable earned income increases. Thus, for certain lower-income individuals, an *"increase"* in their *taxable earned* income will actually *"increase"* the amount of their refund check from the IRS because of a larger *"refundable"* EIC and/or CTC. Some individuals have reported earned income higher than their actual earned income to increase their *refundable* EIC and/or CTC. In a recent Tax Court decision, the Court held that a taxpayer may not report earned income that generates or increases the refundable EIC or CTC unless the taxpayer can properly document that the earned income actually existed. Moreover, in another recent Federal Claims Court case, the Court held that a tax return preparer was subject to a monetary preparer penalty for improperly allowing his client to report undocumented earned income so that the client would receive a larger refundable EIC.

RECENT IRS GUIDANCE

IRS Warns That A Deceased Spouse's IRA Passing To A Surviving Spouse Could Get Caught Up In The "One-Rollover-Per-Year" Trap. Individuals generally may avoid paying tax on a qualifying IRA distribution by rolling over the distribution to the same IRA or to another IRA within the 60-day period beginning with the date the distribution is received. An individual is allowed only *"one"* 60-day, tax-deferred IRA rollover during the one-year (i.e., 12-month) period beginning on the day the Taxpayer received the distribution. If this ***One-Rollover-Per-Year Limitation*** is violated, the rollover amount is treated as a fully taxable distribution and is possibly subject to the 10% early distribution penalty (e.g., if the taxpayer is under 59½). The IRS says that this 1-year limitation applies ***as if all IRAs (including Roth IRAs) are one IRA*.** For example, if an individual takes a distribution from an IRA and rolls that distribution into another IRA within 60-days from the date of receipt, the individual may not rollover another distribution from any IRA (including a Roth IRA) within the one-year period beginning with the date the qualifying rollover distribution was received. Tax Tip! There ***is no limit on the number of "direct" trustee-to-trustee IRA transfers***. Consequently, taxpayers may transfer IRA funds by means of direct trustee-to-trustee transfers as often as they wish.

- Planning Alert! If an individual dies with an IRA and names the surviving spouse as the IRA beneficiary, the surviving spouse has 60 days from the date of the receipt of a distribution from the deceased spouse's IRA to roll the distribution over to the surviving spouse's IRA and avoid being taxed on the distribution. Caution! The IRS recently warned that if a deceased spouse dies with multiple IRAs with the surviving spouse as the beneficiary, the ***One-Rollover-Per-Year Limitation*** applies to distributions from the decedent's multiple IRAs that are rolled over to the surviving spouse's IRAs. To illustrate, let's assume that **1)** A deceased spouse dies with two separate IRAs, **2)** Each IRA names the surviving spouse as beneficiary, **3)** The surviving spouse takes a distribution from each IRA, and **4)** The surviving spouse rolls each distribution into the surviving spouse's IRA. The IRS says that if both of those

rollovers occur within the one-year-rollover period, the second rollover would be taxed.

Proposed Regulations Clarify Certain Child-Related Tax Benefits. The rules allowing various tax benefits for individuals with children and dependents have experienced various statutory changes in 2004 and 2008. Many of those changes involved tax-related benefits available for individuals with a *"Qualifying Child."* A *"Qualifying Child"* may qualify an individual for the following five child-related tax benefits: **1)** *Head-of-Household* filing status; **2)** The *Dependent Care Credit*; **3)** The *Child Tax Credit*; **4)** The *Earned Income Credit*; and **5)** The *Dependency Deduction*. The IRS recently released proposed regulations that, among other things, clarify and update existing regulations dealing with a *"Qualifying Child."* These proposed regulations are lengthy and technical, and a detailed discussion is well beyond the scope of this letter. However, the proposed regulations contain several pro-taxpayer changes and clarifications that are worth noting, including: **1)** For divorced or separated parents, a noncustodial parent may claim benefits relating to a "Qualifying Child" only if such parent attaches a Form 8332 executed by the custodial to his or her return. The proposed regulations provide that, in certain situations, the noncustodial parent may attach the Form 8332 to an amended return; and **2)** The proposed regulations provide guidance on whether two or more taxpayers living in the same dwelling may each qualify or the favorable "Head-of-Household" tax rates. Tax Tip! Although these proposed regulations are not technically effective until published as *"final"* regulations, the IRS says that taxpayers may *"rely"* on the proposed regulations going forward (and back to any *"open year"*). Feel free to call us if you would like additional information.

New Reporting Requirements Invite More IRS Scrutiny And Penalty Exposure For Taxpayers Investing In Certain Syndicated Conservation Easement Arrangements. Over the last several years, placing a *"qualified conservation easement"* (QCE) on real property and deducting the value of the easement as a charitable contribution has become a popular tax-planning strategy for conservation-minded taxpayers who own real estate. In fact, the QCE has become so popular that certain groups have established syndicated investment programs whereby investors can buy an interest in a syndicated pass-through entity (e.g., a syndicated partnership) that, in turn, places a conservation easement on real estate owned by the entity. If effective, the amount of the resulting charitable contribution deduction would flow through to the investors in the entity (e.g. the partnership). In many cases, the deductions passed through to the investors have been substantially more than the amount the investor paid for the investment.

- Caution! The IRS has become concerned that many of these syndicated conservation easement arrangements have become abusive – offering investors much larger charitable contribution deductions than justified. Consequently, the IRS recently announced that syndicated conservation easement transactions and arrangements providing investors in a pass-through entity the possibility of a charitable contribution deduction that equals or ***exceeds two and one-half times*** the amount of their investment will be more closely scrutinized. IRS has classified these transactions as *"Listed Transactions,"* giving rise to IRS disclosure obligations by the investors and certain advisors. These disclosure requirements are detailed, specific, and time sensitive. Failure by investors and/or advisors to comply with these newly-imposed disclosure requirements can result in substantial monetary penalties. These disclosure requirements may apply to transactions entered into as far back as January 1, 2010. Planning Alert! If you think that any of these new disclosure requirements could possibly apply to you, please call our firm as soon as possible. As noted above, these disclosure requirements have specific deadlines.

DEVELOPMENTS IMPACTING PRIMARILY BUSINESSES

PROPOSED TAX REFORM LEGISLATION RELEASED NOVEMBER 2, 2017 – GENERAL OVERVIEW

As discussed previously in this letter, on ***November 2, 2017,*** the House Ways and Means Committee released its initial proposed tax reform bill entitled ***"The Tax Cuts And Jobs Act of 2017"*** (the ***"Act"***). We highlight below selected provisions in the ***Act*** that we believe, if enacted, could have a significant impact on ***Corporate and Non-Corporate Business*** taxpayers. Caution! Over the coming weeks, there will likely be changes to this proposed tax legislation as it works its way through Congress that we do not discuss below. However, we closely monitor major proposed tax legislation in Congress, so feel free to call our firm if you have questions about proposals not discussed below, you need more information on a specific proposal discussed below, or you simply need a status report.

Unless stated otherwise, the proposals listed below generally *would not be effective until 2018*!

Lower Tax Rates And Repeal Of AMT For Regular Corporations. The *Act* would lower the regular corporate income tax to a flat rate of 20% (down from the current maximum rate of 35%). Personal service corporations would be subject to a flat rate of 25%. In addition, the corporate *"Alternative Minimum Tax"* (AMT) would be repealed.

Lower Taxes On "Small Businesses" Taxed As Pass-Through Entities. The *Act* contains a provision designed to ensure that qualified business income that passes through and is reported on an individual owner's tax return will not be taxed at a rate higher than 25% (otherwise this business income could be taxed as high as 39.6% under the proposed new individual tax rates). The provision contains an anti-abuse rule that would make it difficult for most personal service businesses to obtain the benefit of the 25% cap. The personal-service businesses targeted by this anti-abuse rule, include businesses involved in the performance of services in the fields of: health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, and others.

Enhanced First-Year 168(k) Bonus Depreciation. For qualifying property placed-in-service ***after September 27, 2017*** (and before January 1, 2023), the *Act* would enhance the existing *First-Year* ***168(k) Bonus Depreciation*** as follows: 1) ***Increase*** the immediate write-off percentage from the current ***50% to 100%;*** 2) ***Increase*** the first-year depreciation cap generally imposed on passenger vehicles used primarily in business ***from the current $8,000 to $16,000;*** and 3) Allow the ***100% 168(k) Bonus Depreciation*** to be taken on qualifying ***"used"*** business property (under current law, otherwise qualifying property must be ***"new"*** to qualify for the 168(k) Bonus Deduction). Property qualifying for the 168(k) Bonus Depreciation deduction generally includes depreciable *personal* property (e.g., business equipment, computers, certain vehicles, etc), and qualifying improvements to commercial buildings. A more detailed discussion of business property that qualifies for the *168(k) Bonus Depreciation deduction* is provided later in this letter.

Increase In The Caps Imposed On The 179 Deduction. For qualifying *179 Property* ***placed-in-service in tax years beginning after 2017 and before 2023,*** the *Act* would generally enhance the existing ***179 Deduction*** as follows: 1) Increase the annual deduction limitation ***to $5 million*** (currently $510,000 for 2017); and 2) Increase the phase-out threshold ($2,030,000 for 2017) ***to $20 million.*** Qualifying ***179 Property*** generally includes business equipment, computers, certain vehicles, and qualifying capital improvements to certain commercial buildings. A more detailed discussion of business property qualifying for the *179 Deduction* is provided later in this letter.

Small Business Relief For Accounting Methods. The *Act* would streamline various accounting rules for certain small businesses. For example, businesses with average gross receipts during the preceding three years of ***$25 million or less*** generally would: 1) Be able to use the cash method of accounting even if the business has inventories; 2) Be exempt from the UNICAP rules; and 3) Be able to qualify for an exemption to the percentage-of-completion accounting method for qualifying long-term contracts.

New Limitations On Like-Kind Exchanges. ***Effective for exchanges completed after 2017,*** the *Act* would allow §1031

like-kind exchanges ***only with respect to real property*** (i.e., personal property such as business aircraft and artwork would no longer qualify). However, the *Act* would provide a transition rule to allow like-kind exchanges of personal property to be completed if the taxpayer has either ***disposed of the relinquished property*** or ***acquired the replacement property*** *on or before December 31, 2017.*

Caution! We have highlighted only *selected* tax changes contained in the *Act* that would impact businesses, there are many more in this mammoth proposed tax bill! If you have heard about other proposed tax changes not discussed above, and you need more information, please call our office.

RECENTLY-ENACTED LEGISLATION

Congress Authorizes A New Option For Certain Employers That Are Considering A Health Reimbursement Arrangement. Subject to certain safe harbor arrangements, under the current Affordable Care Act (ACA) requirements, any employer (regardless of size) that sponsors a stand-alone ***"Health Reimbursement Arrangement"*** (*HRA*) or an ***"Employer Payment Plan"*** **(*EPP*)**, could face a $100-a-day penalty for each covered employee. The penalty applies only if the employer covers ***at least 2 employees*** under the HRA or EPP. The IRS defines an ***"HRA"*** as an arrangement (funded solely by an employer) that reimburses an employee for qualified medical expenses incurred by the employee ***up to a maximum dollar amount*** for a coverage period. The IRS defines an ***"Employer Payment Plan"*** as an arrangement where the employer reimburses an employee's substantiated premiums for the employee's individual medical insurance coverage (i.e., non-employer sponsored medical insurance coverage), or the employer pays the premiums directly to the insurance company. **Note!**Generally, the payment or reimbursement of individual medical insurance premiums for more-than-2% S corporation shareholder/employees is exempt from the $100-a-day penalty.

- Good News! Last December, Congress passed legislation that now allows an *"Eligible Employer"* to sponsor an HRA or EPP without exposure to the $100-a-day penalty, provided certain requirements are met. These arrangements are called ***"Qualified Small Employer Health Reimbursement Arrangements"*** **(**QSEHRAs). Generally, an *"Eligible Employer"* that adopts a *QSEHRA* could reimburse up to a maximum of $4,950 ($10,000 if the arrangement also covers family members) of a qualifying employee's individual medical insurance policy premiums and/or other qualified medical expenses without incurring the $100-a-day penalty. An *"Eligible Employer"* is an employer that does not otherwise offer a group health plan and that has fewer than 50 full-time and full-time-equivalent employees during the preceding calendar year. **Planning Alert!** A *QSEHRA* must satisfy various technical requirements such as certain anti-discrimination and notification requirements. Please contact our firm if you would like additional information on these plans.

- Planning Alert! On ***October 12, 2017,*** President Trump issued an *Executive Order* entitled ***"Presidential Executive Order Promoting Healthcare Choice and Competition Across the United States."*** Included in that Order is a directive for the Secretaries of the Treasury, Labor, and Health and Human Services to "*consider proposing regulations or revising guidance, to the extent permitted by law and supported by sound policy,* ***to increase the usability of HRAs,*** *to* ***expand employers' ability to offer HRAs*** *to their employees, and to allow HRAs to be used in conjunction with nongroup coverage*." [Emphasis added]. The *Order* stipulates that guidance should be issued "*Within 120 days of the date of this order.*" **Caution!** As we complete this letter, no such guidance has been released. However, when and if released, it is possible that this anticipated guidance could allow an employer to offer its employees HRAs and/or EPPs under rules that are more flexible than the current *QSEHRA* requirements discussed above.

RECENT COURT CASES

<u>Recent Tax Court Case Reminds S Corporation Shareholders That Obtaining Basis Through Loans Can Be Tricky.</u> If you own S corporation stock and your S corporation generates a tax loss for the year, your pass-through losses will not be deductible on your personal return unless and until you have adequate *"basis"* in your S corporation. Any pass-through loss that exceeds your *"basis"* in the S corporation will carry over to succeeding years. You generally have basis to the extent of the amounts paid for your stock (*"stock basis"*), as adjusted for net pass-through income, losses, and distributions, ***plus*** any amounts you have personally loaned to your S corporation ("*debt basis"*). The pass-through losses deplete your *stock basis* first, and once stock basis is fully depleted, you will be entitled to an *immediate* deduction for additional pass-through losses ***only if*** you have sufficient *"debt basis."* Obtaining *debt basis* in your S corporation can be tricky and often receives close scrutiny from the IRS. Over the years, shareholders have argued that they have *"debt basis"* if they personally guarantee a loan made to the S corporation by an outside lender. The IRS and the Courts have consistently said that a shareholder's personal guarantee does not, by itself, create *"debt basis"* for the shareholder. Moreover, in a recent Tax Court case, the Court held that the shareholder's personal guarantee did not create *debt basis* even after the corporation defaulted and the outside creditor obtained a personal judgment against the shareholder. <u>Tax Tip!</u> Generally, the shareholder will obtain *debt basis* for a personal guarantee only if and to the extent the shareholder actually makes payments to the creditor pursuant to the guarantee.

- <u>Planning Alert!</u> If an S corporation anticipates financing losses through borrowing from an outside lender, the best way to ensure the shareholder gets ***debt basis*** is to: 1) Have the shareholder personally borrow the funds from the outside lender, and 2) Then have the shareholder formally (with proper and timely documentation) loan the borrowed funds to the S corporation. It also may be possible to *restructure* (with timely and proper documentation) an existing loan directly to an S corporation from an outside lender in a way that will give the shareholder debt basis. However, for this to work for the current tax year, the loan must be restructured before the year ends. <u>Caution!</u> ***Please do not attempt to restructure your loans without contacting us first.***

<u>Tax Court Identifies New Tax Trap For Accrual-Method S Corporations That Sponsor ESOPs.</u> Generally, if an accrual-basis "S" corporation accrues year-end wages to its non-shareholder employees, the accrual must be paid no later than the 15th day of the third month after year-end to be deductible for the year of the accrual. For example, in order for your accrual-method S corporation to deduct its year-end wage accruals to non-shareholder employees in 2017 (assuming a calendar-year taxpayer), the accrued wages must actually be paid by March 15, 2018. However, if your *"S corporation"* accrues an expense to ***any*** shareholder (regardless of the amount of stock owned), the accrual is not deductible until the ***day*** it is includable in the shareholder's income. Thus, an accrual in 2017 of wages paid to an S corporation shareholder/employee in 2018, is not deductible by the S corporation until 2018 (i.e., the year the wages are paid and includable in the shareholder/employee's income).

- <u>Planning Alert!</u> In a recent Tax Court case that caught many by surprise, the Court held that an accrual-method S corporation may not deduct the accrual of wages to *"any"* employee who is also participating in the S corporation's ESOP, until the tax year the wages are includable in the employee's taxable income. The reason this decision was unexpected is because the Court based its decision on a very technical interpretation of the statutory stock ownership attribution rules. <u>Caution!</u> The holding in this case creates a potential trap for unsuspecting, accrual-method S corporations that sponsor ESOPs. Assuming this decision is not reversed, for an S corporation to take a current year deduction for year-end wages accrued to employees who are also participants in the corporation's ESOP, the wages must be ***"paid"*** by year-end and included in the employees' W-2s for that year.

<u>Recent Cases Address Self-Employment Tax Treatment For Owners Of Limited Liability Companies (LLCs).</u> *"General"* partners of businesses operating as partnerships are generally subject to Social Security and Medicare taxes (Self-Employment Tax or S/E tax) on their business income passing through from their partnership and reported on

Schedule K-1. By contrast, *"limited"* partners are generally exempt from S/E tax on the partnership's Schedule K-1 pass-through business income (except for *"guaranteed payments"* they receive). However, it is not entirely clear whether and to what extent pass-through business income to the owner of a Limited Liability Company (LLC) is subject to S/E tax. In other words, it is not clear when an owner in an LLC is a limited partner only subject to S/E on his or her guaranteed payments. Unfortunately, recent Court decisions do not resolve this issue.

One Recent Tax Court Case ultimately held that attorney-owners of a law firm operating as an LLC were subject to S/E tax on the Firm's pass-through business income, even though the Law Firm paid each owner a *"guaranteed payment"* in an amount that was allegedly *"reasonable compensation"* for the value of the partner's services to the firm (the partners correctly reported the guaranteed payments as S/E income).

Another Recent Tax Court Case dealt with a plastic surgeon who reported the income from his practice as a sole proprietor on a Schedule C and properly paid S/E tax on that income. The plastic surgeon also owned 12.5% of an LLC that operated a surgery center where the remainder of the surgery center was owned by an unrelated group of surgeons. The surgery center was operated by an outside professional management firm. Although the plastic surgeon performed some of his surgeries at the surgery center, his patients would pay the surgery center directly for its use. In this case, the Tax Court held that the pass-through business income from the surgery center to the plastic surgeon (as an LLC Member) was not subject to S/E tax. The Court concluded that the plastic surgeon's ownership interest in the surgery center closely resembled that of an *"investor"* (a limited partner) rather than that of an *"active"* participant in the operations of the surgery center (a general partner).

- Planning Alert! The law in this area continues to be unsettled, and the IRS has yet to issue specific guidance. However, last year the IRS addressed a situation where husband and wife each owned 50% of an LLC that operated a business. The Husband was very active in the business and managed its operations. The Wife had no active involvement in the LLC's business operations. The IRS concluded that the pass-through business income to the Husband was subject to S/E tax. By contrast, the IRS ruled that the pass-through business income to the Wife was not subject to S/E tax, because she was deemed to be a *"mere investor"* and she did not "*actively participate"* in the LLC's operations.

Recent Tax Court Case Illustrates That Poor Documentation May Cause "S" Corporation Shareholders To Lose Their S/E Tax Savings. For 2017, an employer generally must pay FICA taxes of 7.65% on an employee's wages up to $127,200 and FICA taxes of 1.45% on wages in excess of $127,200. In addition, an employer must withhold FICA taxes from an employee's wages of 7.65% on wages up to $127,200 and 1.45% of wages in excess of $127,200. Generally, the employer must also withhold an *Additional Medicare Tax* of .9% for wages paid to an employee in excess of $200,000. For shareholder/employees of an S corporation, this FICA tax generally only applies to their W-2 income from the S corporation. Other income passing through to S corporation shareholder/employees or that is distributed with respect to their stock is generally not subject to FICA taxes or to Self-Employment (S/E) taxes. However, if the IRS determines that the shareholder/employee of an S corporation has been paid unreasonably *"low"* compensation by the S corporation, the Service will generally argue that other amounts the shareholder/employee received from the S corporation (e.g., distributions) are disguised *"compensation"* and should be subject to FICA taxes. Determining *"reasonable compensation"* for S corporation shareholder/employees continues to be a hot audit issue, and the IRS has a winning record in the Courts.

- Caution! Determining *"reasonable"* compensation for an S corporation shareholder is a case-by-case determination, and there are no rules of thumb for determining whether the compensation is *"reasonable."* However, most Court decisions make it clear that the compensation of S corporation shareholders should be supported by independent

data (e.g., comparable industry compensation studies), and should be properly documented and approved by the corporation.

- Practice Alert! In a recent case, a certified financial planner (CFP) set up a wholly-owned S corporation with the intent of reporting his investment advisory fees and commissions on the S corporation's tax return. He also entered into an employment agreement with his S corporation and was paid wages by the S corporation. However, the CFP used his personal name (not the name of his S corporation) with respect to his brokerage contracts with his primary clients. The Tax Court ultimately held that the brokerage fees and commissions should have been reported by the CFP on his personal return and, therefore, all of the fees (rather than just the wages he received from his S corporation) were subject to S/E taxes. The Court based its decision in large part on the fact that the CFP had poor documentation establishing the legal relationships between the CFP, his S corporation, and his primary clients. Caution! When using an S corporation, it is extremely important to follow the appropriate formalities of a corporation (e.g., timely corporate minutes, written employment agreement with owner/employee, written corporate contracts with outsiders, etc.) for the corporation to be fully recognized for tax purposes.

Persons With Any Authority Over Collecting, Accounting For, And/Or Paying An Employer's Payroll Taxes Should Make Sure That All Payroll Taxes Are Actually Paid To The IRS. If an employer fails to properly pay over its payroll taxes, the IRS can seek to collect from any ***"Responsible Person"*** a penalty (commonly referred to as the "Trust Fund Recovery Penalty") equal to 100% of the unpaid ***"Trust Fund"*** taxes (i.e., income tax, social security, and Medicare taxes withheld from an employee's wages by an employer). If this penalty is successfully assessed, the *"Responsible Person"* becomes *"personally"* liable for the assessed penalty. Generally, in order to be liable for the trust fund taxes, an individual must be a ***Responsible Person*** who ***Willfully failed*** to collect or pay over the withheld trust fund taxes. The IRS continues to take many individuals to Court on this issue, and generally has a winning record. Recent examples of Courts addressing this penalty include cases where: **1)** The Sixth Circuit Appeals Court overturned an earlier District Court and held that the President of a company was not liable for the *Trust Fund Recovery Penalty* largely because he was able to convince the Appeals Court that he reasonably believed that the Trust Fund Taxes had been paid; **2)** A District Court held a CEO liable for the *Trust Fund Recovery Penalty* even though he argued that he did not know about the unpaid payroll taxes until after the taxes were delinquent; **3)** A District Court held that a 50% owner who was not responsible for filing payroll tax returns or for paying over the payroll taxes but was very involved in the operations of the business – was liable for the *Trust Fund Recovery Penalty* because, according to the Court: "*[A]s one of two managing members, [Taxpayer]* ***clearly ought to have known*** *that the withholding taxes were not being paid, and .....was* ***certainly in a position to find out*** *for certain.*" [Emphasis added]; and, **4)** A Tax Court case that held that the dad of manager of the business was not a *"responsible person"* (and therefore not subject to the *Trust Fund Recovery Penalty*) solely because he signed four company checks to suppliers while manager/son was out of town. Caution! If you think that you could possibly be classified as a *"Responsible Person"* with respect to an employer's payroll tax obligations, please call our firm and we will help you determine the steps you should take to minimize your exposure to the *"Trust Fund Recovery Penalty."*

RECENT IRS GUIDANCE

Businesses Using Employee Leasing Companies (i.e., Professional Employer Organizations) May Want To Consider Using Professional Employer Organizations That Have Been Certified By The IRS. Many employers out source some or all of their payroll and related tax duties (i.e., withholding, reporting, and paying social security, Medicare, and income taxes) to third-party payroll service providers (Professional Employer Organizations or PEOs). In recent IRS announcements, the IRS has reminded us that even if a business is using a PEO, the business is still considered the *"employer"* and is, therefore, still ***ultimately responsible*** for the deposit and payment of Federal tax liabilities.

Consequently, the IRS says that even where the employer has forwarded the tax amounts to the PEO to make the tax deposits, the employer remains the *"responsible party."* Thus, if the PEO fails to make the Federal tax payments, the employer is liable for all taxes, penalties and interest due, and the IRS may assess penalties and interest on the employer's account. Tax Tip. To help safeguard against an employer being liable for payroll taxes its PEO fails to pay, the IRS suggests that the employer: **1)** Should ensure their PEOs are using ***EFTPS*** **(Electronic Federal Tax Payment System)** so the employers can *"confirm"* that payroll tax payments are being made by the PEOs on behalf of the employer; **2)** Should register with the IRS (using the EFTPS system) and employers should ***get their own PIN*** and use this PIN to periodically verify the payroll tax payments to the IRS; and **3)** Since the IRS will send correspondence regarding any issue to the employer *"at the address of record,"* the IRS strongly suggests that the employer ***does not change their address of record*** to that of the PEO because it may significantly limit the employer's ability to be informed of the IRS payroll tax matters involving their business.

- New IRS PEO Certification Program. Recent legislation created a new IRS program whereby PEOs that meet certain rigid criteria can apply to be *"certified"* by the IRS. A PEO whose application is approved by the IRS becomes a "*Certified Professional Employer Organization"* (CPEO). Generally, if a business retains a CPEO to perform the employment-tax services for qualifying "*work-site employees of the business,"* the CPEO will be treated as the employer (for employment tax purposes) for those qualifying employees, and the business would be released from liability for failure to pay employment taxes for those employees. This Summer, the IRS released its first group of IRS-approved CPEOs.

IRS (And Courts) Are Scrutinizing Certain Micro-Captive Insurance Arrangements. In recent years, an increasing number of profitable (and typically closely-held) businesses have entered into a tax-savings arrangement sometimes referred to as *"Micro-Captive Insurance Arrangements" or "Micro-Captive Transactions."* Generally, a *Micro-Captive Transaction* is a transaction in which a business attempts to reduce its aggregate taxable income by setting up a controlled ("captive") insurance company intended to provide property and casualty insurance to the business. The insured business claims business deductions for premiums paid to its controlled *Captive Insurance Company* for insurance coverage, while the *Captive Insurance Company* makes a tax election to be taxed only on investment income (therefore *"excluding"* the insurance *"premium"* payments received from income). In some of these arrangements, the *Captive Insurance Company* uses the premiums it received for purposes other than administering and paying claims under the insurance contract with the business. For example, the *Captive Insurance Company* might use its premium income to provide a loan to persons or entities related to the insured business.

The IRS has raised concerns regarding *Micro-Captive Insurance Arrangements* as illustrated by the following quote from a recent IRS announcement: *"**In the abusive structure,** unscrupulous promoters, accountants, or wealth planners persuade the owners of closely held entities to participate in these schemes. The **promoters assist the owners** to **create captive insurance companies** onshore or offshore and cause the creation and sale of the captive 'insurance' policies to the closely-held entities. The policies may cover ordinary business risks or esoteric, implausible risks for exorbitant 'premiums,' while the insureds continue to maintain their far less costly commercial coverages with traditional insurers. Captive 'insurance' policies may attempt to cover the same risks as are covered by the entities' existing commercial coverage, but the captive policies' 'premiums' may be double or triple the premiums of the policy owners' commercial policies."* [Emphasis Added].

Based on this concern, the IRS recently identified certain *"Micro-Captive Insurance Arrangements" as "Transactions of Interest."* Therefore, taxpayers participating in these transactions are required to disclose certain information regarding the transaction by filing ***Form 8886 with the IRS.*** Moreover, certain *tax advisors* to these "*Micro-Captive Insurance Arrangements"* will also have record-keeping and IRS reporting requirements. Caution! There are ***rigid***

deadlines for filing these disclosure forms with the IRS that could trigger significant penalties if the filing deadlines are not met. In addition, these new information reporting requirements ***could possibly apply to a taxpayer*** who entered into this type of transaction ***as far back as November 2, 2006.*** Please call our office if you need additional information regarding these time-sensitive reporting requirements.

- Recent Court Case. In a recent Court case that was released after the IRS announced its new disclosure requirements discussed above, the Tax Court denied a taxpayer most of the tax benefits relating to what appears to be a fairly classic *"Micro-Captive Insurance Arrangement."*

IRS Releases Its Latest Automatic Accounting Method Change Procedure. Keeping up with developments involving accounting method changes can be a challenge. It is critically important for anyone considering an accounting method change to be aware of the latest IRS Revenue Procedure containing the list of ***"Automatic"*** *Accounting Method Changes.* While there currently is an IRS user fee of $9,500 for requesting a ***"Non-Automatic"*** *Accounting Method Change,* there is ***no IRS user fee*** for requesting an ***"Automatic"*** accounting method change. On May 5, 2017, the IRS released ***Revenue Procedure 2017-30*** which contains the most recent ***list of accounting method changes*** which may be made ***"automatically"*** (i.e., without obtaining advance permission from the IRS and without paying a user fee). Planning Alert! ***Generally, Forms 3115 filed after April 18, 2017*** to implement an automatic accounting method change ***must follow the updated rules contained in Rev Proc 2017-30.***

IRS Issues Helpful Guidance On Recent Changes To The 179 Deduction And First-Year 168(k) Bonus Depreciation. In late 2015, Congress passed the *"PATH Act"* which made several pro-taxpayer changes to: **1)** The ***179 Deduction*** for the cost of depreciable personal property (e.g., business equipment, computers, certain vehicles, etc.) as well as for *"qualified real property,"* and **2)** The 50% First-Year ***168(k) Bonus Depreciation*** for qualifying depreciable property (e.g., new depreciable *personal* property and certain qualifying depreciable commercial real property). These legislative changes included: Making the temporary increases in the dollar caps to the *179 Deduction* permanent; Making the temporary expansion of the *179 Deduction* to *"Qualified Real Property"* permanent; Temporarily extending the first-year *168(k) Bonus Depreciation* that had previously expired; Expanding the types of improvements to real property that could qualify for the *168(k) Bonus Depreciation*; Eliminating the alternative minimum tax (AMT) impact of *"electing out"* of the *168(k) Bonus Depreciation*; and, Accelerating the date that a taxpayer can take the *168(k) Bonus Depreciation* on certain *"Specified Plants."*

Earlier this year, the IRS released detailed guidance clarifying various aspects of these *PATH Act changes*, including: That the ability *"to make"* the 179 election or *"elect out"* of a previous 179 election on an *"amended"* return is now permanent; That the *PATH Act* did not provide that *all heating and air conditioning units* will now qualify for the *179 Deduction*, but instead only those *heating and air conditioner units* that otherwise meet the requirements of *179 property* will qualify; Additional details and examples as to when a building is *first placed-in-service* for purposes of determining whether building improvements qualify for the *168(k) Bonus Depreciation* as *"Qualified Improvement Property;"* That improvements to an existing *Restaurant Property* could possibly qualify for both the *179 Deduction* and the *168(k) Bonus Depreciation deduction*; and How and when a taxpayer may make the election to take the *168(k) Bonus Depreciation* on *"specified plants"* in the year the plants are *"planted or grafted"* (as opposed to the year the plants begin producing income) along with the impact of that election on the potential 179 election for such "specified plants."

- Planning Alert! These rules relating to the *179 Deduction* and the *168(k) Bonus Depreciation* deduction are, at times, extremely technical and complicated, and the preceding discussion provides only a general overview.

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IRS Announcement Creates Uncertainty As To When A Newly-Constructed Retail Building Or Improvement Is Considered "Placed-In-Service" For Purposes Of Depreciation And The 179 Deduction. Generally, if you are purchasing *"depreciable property"* (equipment, computer, vehicles, buildings, etc.), the property must be *"placed-in-service"* before you can start depreciating it, take the first year *168(k) Bonus Depreciation Deduction*, or take the immediate *179 Deduction* (as discussed in the immediately preceding segment). It is generally assumed that depreciable *"personal"* property (e.g., equipment, vehicles) is *placed-in-service* when the property is ***ready and available*** for use for its intended purpose. In the case of a building (or a building improvement) which is intended to house machinery, equipment, or inventory and which is being constructed or renovated, the building (or improvement) has traditionally been considered *placed-in-service* on the date the construction or renovation is ***substantially complete*** and the building is in a condition or ***state of readiness and availability.***

In 2015, a pro-taxpayer District Court case held that a building that was to be used for the sale of *"retail"* products was *"placed-in-service"* when the taxpayer was issued a *certificate of occupancy* allowing the building to ***receive equipment, shelving, racks and merchandise*** – ***not when*** it was later ***"open for business"*** as the IRS argued. Based on the facts of this case, the Court's holding allowed the taxpayer to take the *168(k) Go-Zone Bonus Depreciation* Deduction on the building for the *tax year before* the building was actually *opened for business.* Planning Alert! Last April, the IRS officially announced that it will continue to contest the holding in this District Court case in fact patterns that are similar to that case. That is, the IRS says that it will not consider a *newly-constructed* or *newly-improved* retail building as being *"placed-in-service"* ***unless and until*** it is **"*ready and available to operate as a retail store.*"** Presumably this means that the IRS will generally not agree that a building is *placed-in-service* until the building is actually *open for business*.

- Tax Tip! For the past several years, Congress has allowed an increased portion of the cost of qualifying commercial buildings and/or building improvements to be deducted in the year the property is *"placed-in-service."* For example, a 50% first-year *168(k) Bonus Depreciation* Deduction is currently allowed for *"qualified improvement property"* (qualifying improvements to an existing commercial building). In addition, up to $510,000 may be taken as an immediate *179 Deduction* for *"qualified real property"* (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property). **Caution!** If your business is incurring expenditures near the end of 2017 that would constitute *"qualified improvement property"* (for purposes of the 50% first-year *168(k) Bonus Depreciation*) or *"qualified real property"* (for the up to $510,000 deduction under Section 179), and the property involves retail sales of merchandise to the general public, making sure that property meets the ***"open to the public"*** test ***by December 31, 2017*** should ensure the deduction for the 2017 tax year without IRS controversy.

Updated IRS Audit Guide Provides Valuable Insights On How IRS Agents Are Instructed To Review Cost Segregation Studies. Generally, the cost of a commercial building must be depreciated over 39 years using the straight-line method (over 27½ years for residential rental buildings). However, *"Cost Segregation Studies"* (*Cost Seg Studies*) are increasingly popular because, if effective, they allow a taxpayer to classify certain costs of a new or used building as non-structural components of the building qualifying for shorter recovery periods resulting in accelerated depreciation deductions. Also, in some situations, the costs broken out as depreciable "personal" property pursuant to an effective *Cost Seg Study* may also qualify for the *179 Deduction* and/or the *168(k) Bonus Depreciation* Deduction. The IRS has recently posted an updated Cost Segregation *"Audit Techniques Guide"* (ATG) providing detailed directives and guidance on how IRS Auditors should approach an audit of a taxpayer's *Cost Seg Study*. The ATG should give taxpayers under audit: 1) A good idea of what IRS Auditors will look for in reviewing a *Cost Seg Study*, 2) Pointers on how to possibly minimize an Auditor's scrutiny, and 3) A survey of the types of issues and situations that could be *"red flags"* to the IRS.

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FINAL COMMENTS

Please contact us if you are interested in a tax topic that we did not discuss. Tax law is constantly changing due to new legislation, cases, regulations, and IRS rulings. Our firm closely monitors these changes. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material represents a general overview of tax developments and should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

Disclaimer: Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.