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Tax Newsletter from the "Power of the Dual View"

The American Academy of Attorney–Certified Public Accountants celebrates its 52nd Anniversary this year. In June the Academy held its annual meeting and education conference in Maui, Hawaii. The members completed 16 hours of legal and CPA training by studying: Audits, Appeals, Tax Court Filings, Charitable Trusts, Tax Exempt Charities, Business Valuations in the Divorce Setting, Whistle Blower Statutes, and Current Tax Law Developments. This Newsletter starts with some of the tax law changes for 2016 to 2019. The second part discusses recent tax law cases and IRS Rulings & Notices. The Newsletter concludes with a section on obtaining a “tax-exempt number” for a small charity.

Tax Laws for 2016 & Beyond

For the last several years Congress was in the bad habit, at the very end of the year, of enacting tax laws good for only one year and sometimes only retroactively. This caused tax planning uncertainty. However in December 2015 numerous tax provisions were made permanent or extended for several years now allowing for mid-year tax planning. The following lists some of the more prevalent deductions and credits that are now permanent or extended.

√ The \$1,000 child tax credit for dependents that are age 16 or less is now permanent. The credit start phasing out for married couples making over \$110,000 (\$75,000 for singles).

√ The \$2,500 college tuition credit for full-time undergraduate studies is now permanent. It phases out for joint filers making over \$160,000.

√ The deduction for the greater of (1) *sales* taxes or (2) state *income* taxes is now permanent This option is particularly valuable for residents in states without income taxes (Texas). But, it can be useful for Oklahoma taxpayers when their state income tax payments are low and particularly helpful if boats, cars, or planes are purchased during the year.

√ The \$250 (\$500 if two married teachers) deduction for classroom teacher supplies is now permanent, it is indexed for inflation, and now includes “professional development courses.”

√ The law allowing an individual age 70 ½ or older to direct annually up to \$100,000 from an IRA to a charity is permanent.

√ The tax laws are also permanent with respect to the expanded Sec. 179 expensing election. For 2016, subject to some limitations, a business can expense up to \$500,000 of tangible personal property. The deduction starts phasing out once purchases exceed \$2,010,000. The deduction and phase out are now also indexed for inflation.

√ Bonus depreciation is 50% for 2016 and 2017, 40% for 2018, and 30% for 2019. **Tax Tip!** Properly utilizing Bonus Depreciation and Sec. 179 can save significant taxes.

√ Limited bonus depreciation for vehicles was extended through 2019. For 2016 first year depreciation on luxury automobiles is \$11,600.

√ Indian depreciation and Indian employment credits are good for 2016, but these two tax provisions are scheduled to expire in 2017.

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√ Federal and State public safety workers (e.g., police, fire, and emergency medical services) can make withdraws from their pension plans starting at age 50 and not incur a 10% premature distribution penalty. The penalty applies for most workers for withdraws when they have not obtained 59 ½.

√ Starting for 2016 partnership tax returns, the filing due date is March 15 and not April 15. Of course the return can be extended. **Tax Trap!** Late filed partnership returns, even though no tax is due, can incur penalties of \$195 per partner for up to 12 months.

√ Starting for 2016 tax returns for calendar year C corporations will be due April 15 instead of March 15. S Corporations are still due mid-March. Of course extensions can be filed.

√ In an effort to fight identity theft, the IRS will end the automatic extension of time to file Form W-2s. W-2s are due January 31.

Interesting Court Cases, IRS Rulings and Notices within the Last Year

√ The US Supreme Court earlier this year interpreted the Affordable Care Act as allowing a tax credit to lower income individuals who purchase their insurance on a federal healthcare exchange where they reside in a state that did not create a state-run exchange. This ruling assisted thousands of low income Oklahomans.

√ A wealthy father loaned his daughter's company \$5,000,000 and the Tax Court held he had to report interest income on the monthly payments even though it is highly unlikely he will ever get back much of his original principal.

√ A care giver for an elderly man had to pay taxes on a \$1,000,000 she claimed the man gifted to her. The Court said it was income.

√ The Tax Court continues to disallow the favorable business bad debt deduction (as opposed to the limited capital loss write-off) for taxpayers loaning money who cannot show they are in the business of lending money. One taxpayer made 12 loans over six years totaling \$925,000 and did not meet the formalities of a lending business. Another taxpayer lost \$359,000 on a loan to his brother's scrap metal company; the Court held he was not in the lending business.

√ The IRS is also winning cases against taxpayers attempting to treat stock and business investment losses (which can be subject to significant limitations) as fully deductible theft losses under the theory corporate management either lied about or stole from the company. The general tax rule is unless management steals directly from the taxpayer, a preferable theft loss is not allowed. These types of investment losses are typically limited to either a capital loss or a nonbusiness bad debt.

√ Several taxpayers lost their court cases when litigating charitable deductions because they failed to include qualified appraisals with their returns, including a taxpayer who deducted "12 fossils" and another who claimed a conservation easement deduction without the proper paper work. **Tax Tip!** Procure a qualified and independent appraisal for non-cash charitable donations in excess of \$5,000.

√ In fact, the Tax Court agreed with the IRS in imposing a 40% penalty when a taxpayer

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claimed a \$1,400,000+ deduction for an easement that was worth only \$80,000; and a similar penalty was assessed against a taxpayer for claiming a \$108,000 deduction when the easement was worth \$0 to \$35,000. Clearly, the taxpayers were too aggressive in these cases.

√ The IRS announced that direct payments by an employer to a gym so its employees could work out pursuant to an employer sponsored wellness plan are taxable income to the employee.

√ The Tax Court held an individual's \$200,000 personal guarantee for bank loans made to a corporation owned by his *self-directed* IRA was a prohibited transaction resulting in \$432,000 (the value of the IRA) of deemed income to the taxpayer and the 10% premature distribution penalty applied. The end result was an IRS bill of over \$150,000 for just *guaranteeing* a loan!

√ In another disaster *self-directed* IRA case, the 8th Circuit held a taxpayer's IRA was disqualified because he received wages from an LLC owned by his IRA. As a result, the IRA lost its status as an IRA and its entire value, \$321,000, was treated as taxable income. The end result was a tax, penalty, and interest bill of over \$150,000 because of a \$29,000 salary!

Tax Tip! Extreme care must be exercised when taxpayers use their *self-directed* IRAs to invest in private businesses, rental properties, etc. For example if a *self-directed* IRA owns rental property and the rents are not sufficient to pay a mortgage, the taxpayer/IRA owner cannot necessarily contribute money to the IRA or otherwise pay the mortgage to avoid foreclosure.

√ The IRS waived the 60-day IRA rollover rule in the following two instances: (1) for a widow who failed to timely roll over an IRA due to the emotional distress of losing her husband; and (2) a wife who failed the 60 day rule because she relied on her husband's financial acumen.

√ The IRS disallowed a "hair braiding" business' tax deductions stating the losses were from a hobby. The Tax Court disagreed stating "sitting in an empty booth in a shopping mall is not...much fun..." and therefore not a hobby. Apparently the IRS was arguing the taxpayer's hobby included not having any business.

√ In another hobby loss case the Tax Court held that a couple whose Amway revenues never exceeded \$2,200 in any year and whose losses averaged \$20,000 per year were not engaged in an activity for profit.

√ The Tax Court recently disallowed most automobile mileage claimed by a taxpayer, citing the strict substantiation requirements for vehicle expenses but stated that the deduction could have been supported by reconstruction if done to the level of credibility of a contemporaneous (timely) record. **Tax Tip!** Proof of oil changes can be an excellent source for substantiating miles driven.

√ The IRS directed that all initial contacts with taxpayers to commence an audit be by letter rather than telephone in light of the abundance of phone scams.

The above two sections are primarily from or edited for this Newsletter using David De Jong's, LLM, CPA - "Tax Update (June 2015 to May 2016)" presentation materials at the AAA-CPAs Summer 2016 education seminar. Mr. De Jong is an Academy member.

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Organizing A Small Tax-Exempt Charity is now Easier

If a charity has an IRS “tax exempt number” it is a donor’s proof that the Service recognizes the organization under Sec. 501(c)(3) of the Internal Revenue Code. If a charity is a “(c)(3)” then donations to it are generally tax-deductible.

The IRS has simplified the procedures to obtain a “tax exempt number” for many small charities. If a new charity projects annual revenues less than \$50,000 a year for the next three years and its assets are less than \$250,000, it likely qualifies for the IRS’s new streamline process to obtain its “tax exempt number.”

Three immediate benefits exist for eligible charities. First, the user fee is \$400 compared to \$850 for larger charities. Two, if the IRS filing is accepted, the turn-around time for issuing the “tax exempt number” is a couple of weeks instead of months for larger charities. Three, the IRS application form, Form 1023-EZ, is a three page form compared to the 20+ page standard Form 1023 for larger charities.

However, a small organization is still required to have the basic organizational documents as larger charities. Most tax exempt charities are corporations. Thus, most small charities are also required to be incorporated as nonprofits. Special nonprofit provisions are included in its Articles of Incorporation. The articles must limit the charity’s activities to exempt purposes, and upon dissolution any remaining assets must be contributed to another qualifying charity.

Exempt purposes typically include activities to help the poor, sick and disabled persons, promote science, religion, education, public

safety, preventing cruelty to animals and children, and promoting amateur sports. Thus, the streamline procedure is an excellent tool for sports booster clubs, PTAs, etc. Recently our office has assisted charities that: (1) raise money for Make-A-Wish, (2) help the disabled acquire wheel chairs, etc., and (3) developing support systems for foster and adopted children.

Charities are further required to have a set of By-laws that are “charity specific.” The charity must also have a “Conflicts of Interest Policy” A conflicts policy governs the procedures charities must adhere to when dealing with “disqualified persons.” Disqualified persons are typically major donors, board members, etc.

In conclusion, the IRS has done a good job helping small charities. The streamline process is completed online and it is a fairly quick procedure. The IRS also provides guidance for drafting nonprofit bylaws and even has a model “Conflicts of Interest Policy.” Thus, operating and raising money for your own charity is no longer only for the wealthy.

The statements contained herein are basic overviews of the covered subjects. Most of these provisions have special rules, conditions, and exceptions. Thus, they are not legal or tax advice. Further, the opinions of the author contained herein are to be viewed as opinions only. Please call 918-599-7755 to see how you can make the most of these suggestions, or if you need help arranging your personal and business affairs to reduce your taxes.

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