Dear Client:

The new tax law has lots of business breaks. We’ll focus here on changes to depreciation.

100% bonus depreciation is back, temporarily. Firms can write off the entire cost of qualifying assets that they buy and place in service after Sept. 27, 2017. It generally lasts until 2022 and then phases out 20% for each year thereafter. Assets bought before Sept. 28, but put into use later, are subject to the old rules.

The break applies to new and used assets with lives of 20 years or less. The cost of qualified film, television or live theatrical productions is eligible, too.

There’s a higher cap on expensing business assets. The maximum amount a taxpayer can expense for new or used business assets instead of depreciating them is $1 million. This limitation phases out dollar for dollar once more than $2,500,000 of assets are placed in service during the year. These higher expensing limits apply to tax years beginning after 2017 and will be indexed annually for inflation.

Property eligible for expensing has been expanded a bit under the new law. Included now are depreciable personal assets used predominantly to furnish lodging such as beds, refrigerators, and stoves for use in hotels, apartments and dormitories. Certain improvements made to commercial buildings are also now eligible for expensing: Roofs, HVAC equipment, fire protection and alarms, and security systems.

Buyers of business vehicles get lots of juicy tax breaks under the new law. The annual depreciation caps for passenger automobiles are going up. For vehicles placed in service after 2017 and for which 100% bonus depreciation is not claimed, the first-year ceiling is $10,000. The second- and third-year caps are $16,000 and $9,600. After that...$5,760. These figures will be inflation-adjusted. If bonus depreciation is claimed, the ceiling increases to $18,000 for the first year.

Buyers of heavy SUVs used for business can write off up to 100% of the cost, thanks to bonus depreciation. SUVs must have a gross weight rating over 6,000 pounds to qualify. It doesn’t matter if the SUV is new or used. And you can also expense up to 100% of the cost of heavy pickup trucks if the cargo bed is at least six feet long.

Separate rules for restaurant, retail and leasehold improvements are gone. They’ve been consolidated under the grouping of qualified improvement property (QIP), which is an improvement to the interior of a commercial building made after the date that the building was placed in service. It doesn’t include escalators or elevators or improvements to the building’s internal structural framework or expansions. QIP is eligible for expensing, but it’s unclear whether it’s eligible for bonus depreciation.

New farm equipment can be depreciated over five years instead of seven years. This doesn’t cover grain bins, cotton ginning assets, fences or land improvements.

The law keeps the current depreciable recovery periods for real estate...

27.5 years for residential rental property and 39 years for commercial realty.
The new tax law makes it riskier to convert a traditional IRA to a Roth IRA. In the past, you had until Oct. 15 of the following year to undo the switch and eliminate the tax bill by transferring the funds back to a traditional IRA. This is called a recharacterization and could make sense if the Roth lost money. Congress decided to eliminate recharacterizations of Roth conversions. Conversions done after 2017 are irreversible. You'll have the ability to convert your traditional IRA to a Roth, but you won't be able to undo the switch. However, you still have time to reverse a 2017 conversion. According to IRS, 2017 Roth conversions can be properly recharacterized up until Oct. 15, 2018.

Unearned income of children is no longer taxed at the parents’ rates. It is instead taxed at rates applicable to trusts, starting with 2018 income. Similar to the pre-2018 rules, the first $1,050 of net unearned income of a child... generally someone under age 19 or under age 24 if a full-time student...is tax-free. The next $1,050 is taxed at the child’s rate. Any unearned income exceeding $2,100 is now taxed at the ordinary income and capital gains rates that apply for trusts. Earned income of children is taxed at the individual tax rates for single filers. Our Letter dated Dec. 29 set forth the new income tax rates for trusts. The rates for long-term capital gains and qualified dividends haven’t changed. But the rates are now based on income thresholds. For 2018, the 0% rate will apply for trusts with taxable incomes up to $2,600. The 20% rate kicks in at incomes over $12,700. The 15% rate applies to incomes in between these amounts. The 3.8% surtax on net investment income hits incomes over $12,500.

The year-end tax changes brought an end to a popular business tax break: The domestic production deduction...the write-off for 9% of income derived from U.S. production activities. Business lobbying groups and tax professionals who were hoping for a two- or three-year phase-out period didn’t get their wish. Repeal is effective for tax years beginning after 2017. This means taxpayers with a fiscal year that straddles 2017 and 2018 may still be eligible for the write-off.

States, Congress and retailers are closely following a Supreme Court case. It could open the door to more online purchases being hit with sales tax. Much of e-commerce now escapes sales tax because a 1992 high court decision shields out-of-state sellers with no physical presence in the buyer’s home state from having to collect sales tax from the buyer. After years of congressional inaction on this issue, many states have chosen to enact their own internet sales tax laws. One such state is S.D., which enacted a law that directly conflicts with the 1992 ruling. After the state’s highest court blocked the law, S.D. appealed and the Supreme Court has agreed to hear the case. Expect arguments this spring and a decision by late June.

N.Y. is serious about reforms to mitigate the impact of the new tax law. In our last Letter, we said the state is looking into ways to get around the $10,000 cap on the deduction of state and local tax payments on federal returns. A new report by the N.Y. Dept. of Taxation and Finance outlines a series of tax-related proposals. They include giving New Yorkers the option to donate to a state-operated charitable fund in exchange for a credit to be used against their N.Y. individual income tax liability. Another idea would decrease personal income taxes and raise employer payroll taxes. Go to www.kiplinger.com/letterlinks/nyreport to view details on all of the options.

Vt. aims to profit off the digital currency craze. A bill in the state legislature would allow digital currency systems to operate in the state through special LLCs. Under the proposal, Vt. would then charge these LLCs a one-cent transaction tax for each unit of currency mined and on each sale or other transfer of the currency. Bitcoin is the best-known of the digital currencies. Others include monero and ripple.
Taking your C corporation’s losses on your individual return is a no-no. Two brothers who were the sole shareholders in a regular C corporation that operated a cattle business deducted the firm’s losses on their 1040 returns. The brothers, who owned the livestock, claimed that the firm acted as their agent. But its overall business purpose was to manage and run the cattle operation. It hired and paid employees, took out workers’ comp and other insurance policies, purchased equipment and feed, and bought and sold cattle in its own name. The losses belong to the corporation...not its stockholders (Barnhart Ranch Company, 5th Cir.).

Making infrequent sales of real estate costs a taxpayer an ordinary loss. The seller, who was a real estate pro, first sought to develop land he owned. But after the development activities stalled and didn’t progress past the planning stage, he put the land in a conservation program and sold it a few years later for a large loss. The loss is taxed as capital loss, the Tax Court says, and not as an ordinary loss. The property wasn’t held for sale in the ordinary course of the taxpayer’s business. He didn’t advertise the parcel for sale, nor did he make major improvements to it. This was the only land he sold over an eight-year period (Conner, TC Memo. 2018-6).

A trust gets a limited tax benefit from donating appreciated realty to charity. The trust owned 99% of a partnership that operated retail craft stores, and it paid tax on its share of the firm’s income. It also bought land and buildings using partnership distributions to fund the purchases. It held the parcels over a year and then donated them to charity. IRS argued the trust’s charitable deduction was limited to its basis in the assets under the applicable federal tax statute. An appeals court agreed with the Service and reversed a 2015 district court decision, which had allowed a fair-market-value charitable write-off (Green, 10th Cir.).

Charity insiders who use funds for personal use can draw a huge tax penalty. The founder and chief executive officer of a 501(c)(3) tax-exempt organization used money in the group’s checking account to pay for a host of personal expenses, such as grocery and department store purchases, home repairs and her son’s tuition. The executive here is hit with a 25% excise tax on the total amount of charitable funds she expended for personal use. She claimed the expenditures were compensation because she didn’t draw a salary for her services to the charity. But IRS and the Tax Court said the payments violated the excess benefit rules. She also owes a 200% excise tax because she didn’t timely repay the charity the amount of the excess benefit, as required under the law (Farr, TC Memo. 2018-2).

A settlement from a tax accounting firm for malpractice is tax-free, the Tax Court says. The firm advised a man to restructure his business as an ESOP-owned S corporation, and the taxpayer followed through with the plan. However, the accountants made a series of errors, including not forming the ESOP and failing to file the S election. The transaction later turned out to be a tax shelter, triggering a large tax bill from IRS. The man sued the accounting firm for malpractice, and the parties later settled the case for much less than what he paid to the Service. The settlement proceeds he got aren’t taxable because they compensated him in part for the taxes he paid as a result of the firm’s malpractice (McKenny, D.C., Fla.).

A not-so-innocent spouse gets innocent spouse relief in this case. A couple who later divorced failed to report on their jointly filed return taxable payouts from the wife’s retirement account, a portion of which was deposited into the couple’s joint checking account. She claimed on audit that her ex-husband should be liable for half the deficiency. IRS and the Tax Court let him off the hook because, although all sides agreed that he should have known about the distribution, there was no proof that he had actual knowledge of it (Bishop, TC Summ. Op. 2018-1).
Two Obamacare taxes are delayed or given a temporary moratorium: The 40% excise tax on employer-sponsored “Cadillac” health plans will now begin in 2022...a two-year postponement from the 2020 start date. And the 2.3% tax on medical device sales is suspended for 2018 and 2019. Both of these taxes, which were put off for two years in the 2015 year-end tax deal, were again delayed by Congress as part of the plan to reopen the federal government.

The Service’s private debt-collection program is off to a shaky start. A 2015 law called for the agency to turn over many inactive tax receivables to private debt collectors in an effort to recoup overdue taxes owed by taxpayers. IRS began the program last spring, and it’s already receiving a boatload of criticism. For example, a report by IRS’s Taxpayer Advocate claims IRS is spending more funds to run the program than it receives in overdue taxes collected by the initiative, and says debt collectors are disproportionately going after low-income taxpayers.

IRS won’t tap military retirement payments of low-incomers for unpaid taxes. Under the taxpayer levy program, IRS has the authority to impose continuous levies on up to 15% of a taxpayer’s monthly military retiree benefits to collect past-due taxes. After hearing from Congress that low-income military retirees were being hit too hard, IRS now says it will put in a filter to exclude from military retiree payment levies those taxpayers with reported income below 250% of the federal poverty level. Due to budgetary constraints, the change will be delayed until this autumn.

Want to apply for or renew a passport? Make sure your taxes are paid up. The State Dept. can deny or revoke U.S. passports of individuals with federal tax debts in excess of $51,000 and on whom a tax lien has been filed or a levy has been issued. It doesn’t include those who are paying their taxes under an installment agreement, individuals in bankruptcy, people who live in a federally declared disaster area, or people with a tax debt that IRS has determined isn’t collectible because of hardship.

IRS is giving names of affected taxpayers to the State Dept. The agency is also sending notices to people, letting them know their name has been submitted. Before denying passports, State will give people 90 days to resolve tax delinquencies, such as by paying the debt in full or agreeing to a payment plan with the Service.

Thinking of hiring a cybersecurity professional to protect electronic records? IRS has some tips. The agency says it’s becoming more common for preparers to hire security experts to help safeguard computer systems, e-records and client data. Preparers should ask candidates about ransomware protection, options for data backup, remote access tools, data encryption, malware, security fixes and many other items.

Tax pros who call IRS’s toll-free lines must give more personal information about themselves to help customer service representatives confirm their identities. They’ll have to supply their Social Security number and date of birth, for example, in addition to their name and Centralized Authorization File number. These changes apply not only when preparers call the Practitioner Priority Service line in expectation of quicker service, but also when they call other IRS toll-free numbers.

Yours very truly,

Jan. 26, 2018

THE KIPLINGER WASHINGTON EDITORS

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