Dear Client:

The GOP is about to pass major tax changes... Just in time for the holidays. At press time, we still don't know what exactly will be in the law, but we have a good idea of the big-ticket items. Congress wants to vote on it next week. President Trump will sign it posthaste. Enacting tax cuts is a legislative priority for him, and he is eager to deliver on this campaign promise. Most tax changes will take effect in 2018.

Many big items are getting lots of publicity. Reducing the corporate tax rate to 21%...not 20%... starting in 2018. Ending Obamacare’s “buy health insurance or pay a fine” mandate. Lowering the top individual rate to 37%. Allowing home mortgage interest deductions on up to $750,000 of new acquisition debt...down from $1 million under present law. Letting some self-employed and owners of pass-throughs deduct 20% of income. Capping the write-off for state and local income, sales and property taxes at $10,000. Hiking the child credit and standard deduction and eliminating personal exemptions. Repealing the corporate alternative minimum tax, but keeping the individual AMT with a far higher exemption amount. Preserving the medical expense deduction. Expensing of business assets. Also, retaining the estate tax with a higher exemption.

Last-minute negotiations leave the details of many proposals up in the air. Among the ones for individuals: Axing the deduction for job-related moves. Paring back miscellaneous itemized deductions subject to the 2%-of-AGI threshold. Making alimony nondeductible to the payer spouse and tax-free to the recipient for post-2017 divorce decrees. Plus barring recharacterizations of Roth IRA conversions.

Among the long list of business-related proposals not getting much press: Limiting like-kind swaps to real property. Axing the domestic production deduction. Setting a cap on the amount of deductible losses from pass-through businesses. Hiking depreciation ceilings for luxury autos. Capping the write-off that firms claim for interest paid on debt. Denying deductions for settling sexual harassment claims if subject to a nondisclosure agreement. Revising rules for taking net operating losses.

Whatever is included in the final package, there is one thing that's certain: Tax professionals and IRS will be kept busy interpreting all of the new rules. You can bet on lots of transitional rules, and the fact that many of the provisions will be temporary, or phase in or out over time, will be sure to create a tangled web of complexity and uncertainty for individual and business taxpayers and their advisers. IRS will have to issue mounds of new guidance and revise many of its forms. We now know that release of 2018 withholding tables will be delayed a bit. Payroll companies want the Service to clarify that until revised tables and W-4 forms are issued, employers can use the current-law W-4 forms submitted by workers.

Our next Letter will detail how the changes will affect you and your business.
The basic Medicare Part B premium will remain at $134 for 2018, although some enrollees will pay less because of a provision in the law that limits premium hikes to the size of cost-of-living hikes in Social Security benefits. Upper-income seniors will pay more for Parts B and D coverage next year if their modified adjusted gross income for 2016 exceeded $170,000 for joint filers or $85,000 for single people. Here, modified AGI is AGI plus any tax-exempt interest. For Part B coverage, they pay the $134 basic monthly premium plus a surcharge. They'll also owe a surcharge on their monthly Part D premiums for prescription drugs. New rules taking effect in 2018 impose the higher surcharges on more enrollees. Take a close look at the table below, which summarizes the impact for upper-incomers.

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<th>For Joint Filers</th>
<th>For Single Filers</th>
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<td>If your 2016 modified AGI is</td>
<td>Your 2018 monthly Part B premium will be</td>
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<td>More than $170,000</td>
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Married couples who file separate income tax returns will be hit hard if they lived with their spouse in 2016. They'll pay $428.60 a month for Part B and owe a $74.80 Part D surcharge if their 2016 modified AGI exceeded $85,000.

ABLE savings programs for the disabled are quickly expanding. 30 states have now launched ABLE programs. People who live in a state without such a program can participate in another state’s plan. These accounts, akin to 529 college savings plans, allow nondeductible payins of up to $14,000 a year... $15,000 in 2018...to help people who became blind or disabled before the age of 26. Distributions of earnings are tax-free if used for housing, job training and the like.

Congress is eyeing some favorable changes for ABLEs. One proposal would allow limited tax-free rollovers from 529 college savings plans to ABLE accounts. Another would let ABLE account beneficiaries make payins to their accounts over the current law’s annual contribution limit, subject to certain restrictions, and would make contributions to ABLE accounts eligible for the saver’s tax credit.

Hurricane victims get guidance on claiming disaster losses on 2016 returns. A new law lets victims of Hurricanes Harvey, Irma and Maria take a write-off for uninsured personal casualty losses from the storms in excess of a $500 threshold, even if they don’t itemize. This net loss is treated as an additional standard deduction. This year’s hurricane losses can be claimed on 2016 or 2017 tax returns. If you’ve filed your 2016 return, you can claim the loss on an amended return. And if you haven’t yet filed your 2016 return, you have until Jan. 31, 2018, to do so. You’ll have to file a paper return if you’re claiming the loss for 2016. And make sure to write the name of the hurricane and “Tax Relief” on the top. IRS has revised the 2016 Form 4684...the form used to figure the loss. It’s a draft right now. According to the document and its instructions, folks would compute the loss on the 4684. They would then transfer the amount to Line 28 of Schedule A...titled “Other”...and write “Net Hurricane Disaster Loss.” If they’re not itemizing, then they’d also put their standard deduction on Line 28 and write next to it, “Standard Deduction Claimed with Hurricane Disaster Loss.” It’s a sure bet that the 2017 Form 4684 will have a similar set of instructions.
Want to claim an alimony deduction? Make sure you meet this requirement: The payer’s liability for the payments must end when the former spouse dies.
You’d be surprised at how many divorce or separation decrees run afoul of this rule.

IRS agents are trained to sniff this out. Here’s an example from the Tax Court. A U.K. divorce agreement was silent on the existence of a postdeath payment obligation, so the Court looked to the law of the jurisdiction that issued it. And under English law, the ex-husband’s obligation to pay his ex-wife wouldn’t have ended upon her death.

As a result, the payment is not deductible alimony (Wolens, TC Memo. 2017-236).

A man can’t deduct legal fees he incurred to recoup overpaid alimony, the Tax Court decides. After paying alimony to his ex-wife for more than 10 years, the man filed a lawsuit against her, claiming she breached the separation contract and he was entitled to recover amounts he paid. He claimed an itemized deduction for his lawsuit-related legal fees. The Court disallowed the write-off as personal because the litigation arose from his former marriage (Barry, TC Memo. 2017-237).

A company’s S-corporation tax status needn’t be preserved in bankruptcy. Shortly before a firm filed for bankruptcy, the owners revoked its S election. They most likely did this so that any income from the debt that would be canceled in bankruptcy or gains from a forced sale of the firm’s assets wouldn’t be taxed to them. The trustee argued that the S-election revocation was invalid and a fraudulent transfer, but a bankruptcy court rejected this claim, saying the debtor’s S-corporation status isn’t a property right of the bankrupt firm (Health Diagnostic Laboratory, D.C., Va.).

Using an internet stamp site doesn’t cost a couple a date in Tax Court. The day before the Tax Court petition was due, their lawyer’s assistant printed out a stamp and label date from a postage software website and affixed them to the package before taking it to the post office. The envelope didn’t include a postmark from the post office. The Court received the petition eight days later. Following the lead of a 2017 appeals court decision on a similar set of facts, the Tax Court here said that the petition was timely mailed and thus timely filed (Pearson, 149 TC No. 20).

Intrafamily transactions in small firms are closely eyed by IRS auditors. Take this case. A company advanced millions of dollars to the founder’s son. Although the payments were evidenced by promissory notes with fixed maturity dates, many notes didn’t have original signatures. The firm had no way to enforce repayment. Also, it continued to advance funds even after the son failed to repay amounts that were due on earlier advances. The Tax Court said there wasn’t bona fide debt and disallowed the company’s bad debt deductions (VHC, TC Memo. 2017-220).

A producer dad can’t deduct the cost of his son’s college filmmaking courses. The father owned a movie production company and wanted to bring his college-age son into the family business. The son took a few introductory classes in the subject at school and was able to apply some of the skills he learned helping out his father. The dad incorrectly thought that qualified the tuition costs as deductible expenses. But we have to give credit to the dad for this nice try. (Cristo, TC Memo. 2017-239).

An accrual-method taxpayer can’t deduct estimated rebates at year-end, IRS says privately. A for-profit school provides students with a tuition reduction if they meet two requirements: Successfully completing classes in the current year plus attending the first two weeks of classes at the same school in the following year. The taxpayer estimated the cost of the tuition rebates and took the tax write-off for the year the students finished the first prong. The Service says this is improper because the school’s liability for the tuition rebates wasn’t fixed at that time. It can’t take a deduction until the two-week attendance requirement is also satisfied.
The **2018 standard mileage rate** for business driving will rise to 54.5¢ a mile, up 1¢ from 2017. Businesses with four or fewer vehicles can use this rate, but each vehicle’s basis must be reduced by the depreciation component...25¢ a mile. The rate for medical travel and moving will go up 1¢, to 18¢ per mile. For now, the 2018 allowance for charitable driving will stay put at 14¢ a mile because it’s fixed by law, although there’s a legislative proposal to annually adjust it. You can also claim the cost of parking and tolls. But you can’t add the cost of fuel or repairs. Nor can you use these rates if you depreciated or expensed the car.

Did you sell bitcoins for a big gain this year? Don’t forget to pay your taxes. Bitcoins and other virtual currency are treated as property for tax purposes. So those who sell or exchange bitcoins will realize gain or loss on the transaction. The profit or loss will be capital gain or loss if the bitcoins were held for investment, similar to stocks or bonds. If you’ve accepted bitcoins as payment for goods or services, you must include in income the value in U.S. dollars. Employers that pay wages with bitcoins need to report the U.S. dollar value of the earnings on W-2 forms.

**IRS gets a partial court victory in its quest to seek out users of bitcoins.** After an examiner found three people who were using the virtual currency to evade tax, IRS issued a broad summons to Coinbase, a virtual currency exchange, seeking names and records of U.S. customers who bought and sold bitcoins through the company. Although IRS later narrowed the summons, Coinbase continued to oppose it. A district court has now decided to narrow the summons request even further and ordered Coinbase to produce limited records to IRS ([Coinbase, D.C., Calif.](http://www.cointelegraph.com/)).

**Preparer groups and IRS are eagerly awaiting a ruling from an appeals court.** The case involves IRS’s annual filing-season program for unenrolled preparers. In 2014, the American Institute of Certified Public Accountants sued the Service, challenging this voluntary program as improper. After a district court sided with IRS, AICPA appealed the lower court’s ruling. Oral arguments were held in early Oct., and we expect the appeals court to issue its decision within the next few months.

**IRS**’s appeals offices will be offering more face-to-face conferences in field audit cases, much to the delight of tax experts who have bemoaned the division’s ever-increasing reliance on phone and video conference meetings. The downside is that the agency isn’t expanding in-person appeals office meetings to taxpayers protesting adjustments made by examiners in correspondence audits.

**Proposals to revamp IRS won’t be included in the Republican tax package.** As expected, GOP taxwriters have decided to delay any overhaul of the agency until after the passage of tax cuts. That doesn’t mean the idea is off the table. It’s still a Republican priority, as evidenced by congressional hearings on the topic. A proposal floated in the past called for IRS to be restructured into three units: One would serve individuals. A second would focus primarily on business taxpayers. The third would act as an independent small claims court for routine tax disputes.

We’ll see whether the bill will address some narrow tax procedure issues. The Senate would bar IRS from hiking fees for folks who use installment agreements and would waive fees for lower-incomers. It would also give taxpayers two years... up from nine months now...to file suit against IRS to try to recover levied funds.

Happy Holidays
Dec. 15, 2017

Yours very truly,

The Kiplinger Editors

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