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Leslie A. Cesario, Ltd. Monthly Newsletter

Scammers Impersonating IRS Agents Called You Yet?

Article Highlights:

- Scams Impersonating IRS Agents
- Protecting Against Scams
- Protecting Against ID Theft
- What to Do If Your ID Has Been Compromised

The Treasury Inspector General for Tax Administration (TIGTA) has indicated it is making significant progress in its investigation of the IRS impersonation scams that are sweeping the nation, causing reported taxpayer losses of more than $36 million and averaging more than $5,700 per taxpayer. To date, TIGTA has logged approximately 1.2 million calls reported by taxpayers, and nearly 6,400 people have reported that IRS impersonators have fleeced them.

In one instance, a taxpayer was so convinced the scammer was an IRS agent he rushed off to make a payment and was involved in a traffic accident. He was so worried about the scammer's threats of legal action that he actually left the scene of the accident so he could promptly get the funds wired to the scammer. In this case TIGTA was able to trace the victim's wire transfer and ultimately nabbed a ring of five scammers.

But these stories generally don't have happy endings, so it is important for everyone to understand that the IRS never demands payment by wire, MoneyGram, debit cards or the like, and it always makes initial contact by mail.

Protect Yourself and Loved Ones from Being a Scam Victim:

1. Hang up on callers claiming to be IRS agents, IRS collection agents or state taxing authorities demanding immediate payments. They are not legitimate.
2. Take the time to educate your loved ones, especially those who might be vulnerable, about these scams and take steps necessary to protect them from scams.
3. Call this office if you need assurances or wish to confirm you do not have an outstanding balance with a tax authority.
4. Report scams and attempted scams on the TIGTA website.

Protect Against Identity Theft – In addition to scammers, watch out for those ID thieves out there looking for vulnerable IDs to steal. You may think it will never happen to you, but if it does, it will become a nightmare and could take years to straighten out. So you need to protect yourself against ID theft by limiting the exposure of your personal and financial information as much as possible.

What do ID thieves need to create havoc for you? Your name, Social Security number and birth date! Here are some tips to limit your ID exposure:

- Don't carry your Social Security card – or any document that includes your Social Security number (SSN), for that matter – in your wallet, purse or briefcase. Your Social Security card combined with your driver's license provides scammers with the three pieces of information they need.
- Don't give out either your SSN or your birth date without questioning the need and making sure it is a legitimate request and really necessary.
- Limit the number of credit cards and credit accounts you have. Each account has your SSN, so the more accounts you have, the greater the chance you'll be caught

up in a data breach and your ID will be compromised. It is far easier to deal with one credit card company than several if your ID is breached.

- Be proactive and periodically change the passwords for your online accounts that include sensitive financial information. It is a pain, but it could avoid you a major headache.
- Although only the last four digits of your SSN are used on most financial documents, you should still pay close attention to documents that include your full SSN or birth date. Limit their duplication and distribution and ensure they are properly disposed of when you discard them.
- Never include your SSN, birthdate or other sensitive financial information in an e-mail or in documents attached to an e-mail.

Use common sense and follow the "need-to-know" rule when disclosing your financial information. Careless safeguarding of your information can lead to big problems.

Think Your ID Has Been Compromised? You should immediately:

- File a complaint with the Federal Trade Commission at www.identitytheft.gov and complete a report. In addition to taking the report, the site will develop an ID Theft Affidavit that you can use when reporting the ID theft to creditors and others. The site will also walk you through various steps to be taken depending upon the specifics of your ID theft.
- Contact one of the three major credit bureaus to place a "fraud alert" on your credit records and review your credit report for fraudulent activity:
    - Equifax, www.Equifax.com, 1-800-766-0008
    - Experian, www.Experian.com, 1-888-397-3742
    - TransUnion, www.TransUnion.com, 1-800-680-7289
- Contact your financial institutions and close any financial or credit accounts opened without your permission or tampered with by identity thieves.
- Report any fraud to your local police and retain a copy of the police report to use when reporting fraud to other agencies or creditors.

You should also contact this office immediately so steps can be taken to avoid fraudulent returns being filed using your SSN. Even if someone has already e-filed a return and claimed a refund under your SSN, your refund may still be safe.

However, you cannot e-file and instead must file a paper return with the proper documentation; you will ultimately receive the refund you are due, but it will be severely delayed. Once the IRS recognizes that your SSN was used to file a fraudulent return, it will block your SSN from filing and assign you an alternative filing number for the subsequent year.

For more information on how and what to file when someone else has filed using your SSN, please contact this office.

Do You Need a Mid-Year Tax Checkup?

Article Highlights:

- Procrastination Can Lead to Unneeded Taxes & Penalties
- Events That Create Tax Problems & Opportunities
- Mid-Year Tax Checkup

If you are inclined to procrastinate until the end of the year or, even worse, until tax-filing season to worry about your taxes, you may be missing out on opportunities to reduce your tax and avoid certain penalties. The following are some events that can affect your tax return; you may need to take steps to mitigate their impact and avoid unpleasant surprises after it is too late to address them.

- ❑ Did you get married, get divorced, or become widowed?
- ❑ Did you change jobs or has your spouse started working?
- ❑ Did you have a substantial increase or decrease in income?
- ❑ Did you have a substantial gain from the sale of stocks or bonds?
- ❑ Did you buy or sell a rental?
- ❑ Did you start, acquire, or sell a business?
- ❑ Did you buy or sell a home?
- ❑ Did you retire this year?
- ❑ Are you on track to withdraw the required amount from your IRA (age 70.5 or older)?
- ❑ Are you taking advantage of the IRA-to-charity transfers (age 70.5 or older)?
- ❑ Did you refinance your home or take out a second home mortgage this year?
- ❑ Were you the beneficiary of an inheritance this year?
- ❑ Did you welcome a new child into your family? Time to consider a tax-advantaged savings plan!
- ❑ Are you taking advantage of tax-advantaged retirement savings?
- ❑ Have you made any significant equipment purchases for your business?
- ❑ Are you planning to purchase a new business vehicle and dispose of the old one? It makes a significant difference whether you sell or trade in the old vehicle.
- ❑ Are your cash and non-cash charitable contributions adequately documented?
- ❑ Did you, or are you planning to, make energy-efficiency improvements to your main home or install a solar system for your main or second home this year?
- ❑ Are you paying college tuition for yourself, your spouse or dependent(s)?
- ❑ Are you keeping up with your estimated tax payments or do they need adjusting?
- ❑ Did you purchase your health insurance through a government insurance marketplace and qualify for an insurance premium subsidy? If your income subsequently increased, you may need to be prepared to repay some portion of the subsidy.
- ❑ Do you have substantial investment income or gains from the sale of investment assets? If so, you may be hit with the 3.8% surtax on net investment income and need to adjust your advance tax payments.
- ❑ Did you make any unplanned withdrawals from an IRA or pension plan?
- ❑ Have you stayed abreast of every new tax law change?

If you anticipate or have already encountered any of the above events or conditions, it may be appropriate to schedule a mid-year tax checkup and consult with this office—preferably before any of the events listed, and definitely before the end of the year.

Short-Term Rental, Special Treatment

Article Highlights:

- Airbnb, VRBO, and HomeAway
- Rented for Fewer than 15 Days During the Year
- The 7-day and 30-day Rules
- Exceptions to the 30-Day Rule
- Schedule C Reporting

If you are one of the many taxpayers who rents out a first or second home using rental agents or online rental services (such as Airbnb, VRBO and HomeAway) that match property owners with prospective renters, then some special tax rules may apply to you.

These special (and sometimes complex) taxation rules can make the rents that you charge tax-free. However, other situations may force your rental income and expenses to be treated as a business reported on a Schedule C, as opposed to a rental activity reported on Schedule E**.**

The following is a synopsis of the rules governing short-term rentals.

Rented for Fewer than 15 Days During the Year – When a property is rented for fewer than 15 days during the tax year, the rental income is not reportable, and the expenses associated with that rental are not deductible. Interest and property taxes are not prorated, and the full amounts of the qualified mortgage interest and property taxes are reported as itemized deductions (as usual) on the taxpayer's Schedule A.

The 7-Day and 30-Day Rules – Rentals are generally passive activities. However, an activity is not treated as a rental if either of these statements applies:

A. The **average** customer use of the property is for 7 days or fewer—or for 30 days or fewer if the owner (or someone on the owner's behalf) provides significant personal services.

B. The owner (or someone on the owner's behalf) provides extraordinary personal services without regard to the property's average period of customer use.

If the activity is not treated as a rental, then it will be treated as a trade or business, and the income and expenses, including prorated interest and taxes, will be reported on Schedule C. IRS Publication 527 states: "If you provide substantial services that are primarily for your tenant's convenience, such as regular cleaning, changing linen, or maid service, you report your rental income and expenses on Schedule C." Substantial services do not include the furnishing of heat and light, the cleaning of public areas, the collecting of trash, and such.

Exception to the 30-Day Rule – If the personal services provided are similar to those that generally are provided in connection with long-term rentals of high-grade commercial or residential real property (such as public area cleaning and trash collection), and if the rental also includes maid and linen services that cost less than 10% of the rental fee, then the personal services are neither significant nor extraordinary for the purposes of the 30-day rule.

Profits & Losses on Schedule C – Profit from a rental activity is not subject to self-employment tax, but a profitable rental activity that is reported as a business on Schedule C is subject to this tax. A loss from this type of activity is still treated as a passive-activity loss unless the taxpayer meets the material participation test – generally, providing 500 or more hours of personal services during the year or qualifying as a real estate professional. Losses from passive activities are deductible only up to the passive income amount, but unused losses can be carried forward to future years. A special allowance for real-estate rental activities with active participation permits a loss against nonpassive income of up to $25,000 – phasing out when modified adjusted gross income is between $100K and $150K. However, this allowance does **NOT** apply when the activity is reported on Schedule C.

These rules can be complicated; please call this office to determine how they apply to your particular circumstances and what actions you can take to minimize tax liability and maximize tax benefits from your rental activities.

Tax Breaks for Hiring Your Children in Your Family Business

Article Highlights:

- Child Under the Age of 19 or a Student Under the Age of 24
- Kiddie Tax
- Tax on a Child's Earned Income
- Deduction for the Business
- Employment Taxes
- IRAs and Retirement Plans

With school vacation time just around the corner and employees heading out for summer vacations, you might consider hiring your children to help out in your business. Financially, it makes more sense to keep the family employed rather than hiring strangers, provided, of course, that the family member is suitable for the job.

Rather than helping to support your children with your after-tax dollars, you can instead hire them in your business and pay them with tax-deductible dollars. Of course, the employment must be legitimate and the pay commensurate with the hours and the job worked. The following are typical situations encountered when hiring family members.

Employing a Child – A reasonable salary paid to a child reduces the self-employment income and tax of the parents (business owners) by shifting income to the child.

When a child under the age of 19 or a student under the age of 24 is claimed as a dependent of the parents, the child is generally subject to the kiddie tax rules if their investment income is upward of $2,100. Under these rules, the child's investment income is taxed at the same rate as the parent's top marginal rate using a lower $1,050 standard deduction. However, earned income (income from working) is taxed at the child's marginal rate, and the earned income is reduced by the lesser of the earned income plus $350 or the regular standard deduction for the year, which is $6,300 for 2016. Assuming that a child has no other income, the child could be paid $6,300 and incur no income tax. If the child is paid more, the next $9,275 he or she earns is taxed at 10%.

Example: You are in the 25% tax bracket and own an unincorporated business. You hire your child (who has no investment income) and pay the child $11,800 for the year. You reduce your income by $11,800, which saves you $2,950 of income tax (25% of $11,800), and your child has a taxable income of $5,500, $11,800 less the $6,300 standard deduction) on which the tax is $550 (10% of $5,500).

If the business is unincorporated and the wages are paid to a child under age 18, he or she will not be subject to FICA – Social Security and Hospital Insurance (HI, aka Medicare) – taxes since employment for FICA tax purposes doesn't include services performed by a child under the age of 18 while employed by a parent. Thus, the child will not be required to pay the employee's share of the FICA taxes, and the business won't have to pay its half either. In addition, by paying the child and thus reducing the business's net income, the parent's self-employment tax payable on net self-employment income is also reduced.

Use the same example from above. Assuming your business profits are $130,000, by paying your child $11,800, you not only reduce your self-employment income for income tax purposes, but you also reduce your self-employment tax (HI portion) by $316 (2.9% of $11,800 times the SE factor of 92.35%). But if your net profits for the year were less than the maximum SE income ($118,500 for 2016) that is subject to Social Security tax, then the savings would include the 12.4% Social Security portion in addition to the 2.9% HI portion.

A similar but more liberal exemption applies for FUTA, which exempts from federal unemployment tax the earnings paid to a child under age 21 while employed by his or her parent. The FICA and FUTA exemptions also apply if a child is employed by a partnership consisting solely of his parents. However, the exemptions do not apply to businesses that are incorporated or a partnership that includes non-parent partners. Even so, there's no extra cost to your business if you're paying a child for work that you would pay someone else to do anyway.

Retirement Plan Savings - Additional savings are possible if the child is paid more (or works part-time past the summer) and deposits the extra earnings into a traditional IRA. For 2016, the child can make a tax-deductible contribution of up to $5,500 to his or her own IRA. The business also may be able to provide the child with retirement plan benefits, depending on the type of plan it uses and its terms, the child's age, and the number of hours worked. By combining the standard deduction ($6,300) and the maximum deductible IRA contribution ($5,500) for 2016, a child could earn $11,800 of wages and pay no income tax.

However, referring back to our original example, the child's tax to be saved by making a $5,500 traditional IRA contribution is only $550, so it might be appropriate to make a Roth IRA contribution instead, especially since the child has so many years before retirement and the future tax-free retirement benefits will far outweigh the current $550 savings.

If you have questions about the information provided here and other possible tax benefits or issues related to hiring your child, please give this office a call.

School's Out - Who Is Going to Take Care of the Kids?

Article Highlights:

- Child Age Limits
- Employment-Related Expense
- Married Taxpayer Earnings Limits
- Disabled or Full-Time-Student Spouse
- Expense Limits

Summer has just arrived, and there is a tax break that working parents should know about. Many working parents must arrange for care of their children under 13 years of age (or any age if handicapped) during the school vacation period. A popular solution — with a tax benefit — is a day camp program. The cost of day camp can count as an expense toward the child and dependent care credit. But be careful; expenses for overnight camps do not qualify.

For an expense to qualify for the credit, it must be an "employment-related" expense; i.e., it must enable you and your spouse, if married, to work, and it must be for the care of your child, stepchild, foster child, brother, sister or stepsibling (or a descendant of any of these) who is under 13, lives in your home for more than half the year and does not provide more than half of his or her own support for the year. Married couples must file jointly, and both spouses must work (or one spouse must be a full-time student or disabled) to claim the credit.

The qualifying expenses are limited to the income you or your spouse, if married, earn from work, using the figure for whoever earns less. However, under certain conditions, when one spouse has no actual earned income and that spouse is a full-time student or disabled, that spouse is considered to have a monthly income of $250 (if the couple has one qualifying child) or $500 (two or more qualifying children). This means the income limitation is essentially removed for a spouse who is a student or disabled.

The qualifying expenses can't exceed $3,000 per year if you have one qualifying child, while the limit is $6,000 per year for two or more qualifying persons. This limit does not need to be divided equally. For example, if you paid and incurred $2,500 of qualified expenses for the care of one child and $3,500 for the care of another child, you can use the total, $6,000, to figure the credit. The credit is computed as a percentage of your qualifying expenses; in most cases, 20%. (If your joint adjusted gross income [AGI] is $43,000 or less, the percentage will be higher, but it will not exceed 35%.)

> *Example:* Al and Janice both work, each with earned income in excess of $40,000 per year. Janice has a part-time job, and her work hours coincide with the school hours of their 11-year-old daughter, Susan. However, during the summer vacation period, they place Susan in a day camp program that costs $4,000. Since the expense limitation for one child is $3,000, their child credit would be $600 (20% of $3,000).

The credit reduces a taxpayer's tax bill dollar for dollar. Thus, in the above example, Al and Janice pay $600 less in taxes by virtue of the credit. However, the credit can only offset income tax and alternative minimum tax liability, and any excess is not refundable. The credit cannot be used to reduce self-employment tax or the taxes imposed by the Affordable Care Act.

If you have questions about how the childcare credit applies to your particular tax situation, please give this office a call.

Solar Tax Credits – Before You Take the Leap

Article Highlights:

- Non-Refundable Tax Credit
- Qualifications
- Installation Costs
- Financing

When you see those TV ads for home solar power, you may get the impression that Uncle Sam is going to pick up 30% of your cost and you only have to come up with the other 70%. That is not necessarily the whole picture. True, the federal government has a 30% tax credit for the cost of a qualified solar installation (some states also have solar credits or other incentives). However, the federal credit is non-refundable and can only be used to offset your current tax liability, and any excess carries over to future years as long as the credit still applies in future years. Currently, the credit is allowed through 2021. What this means: You may not get all the credit in the first year as you might have been led to believe or assumed based upon the TV ads.

> *For example, suppose your solar installation costs $25,000. That would qualify you for a solar tax credit of $7,500. But suppose the income tax on your tax return is only $4,000. Then, the credit would reduce your tax liability to zero, and the other $3,500 ($7,500 - $4,000) of the credit is carried over to the next year's tax return, where the credit will be limited to that year's tax amount. If your tax is again less than the amount of the credit, the excess credit carries to the following year, and so on, until the credit is used up or the credit expires.*

To qualify for the credit, the equipment must be installed in a home that is located in the U.S. and that you use as your residence. The credit can't be claimed for equipment that is used to heat a swimming pool or hot tub. If the equipment is used more than 20% for business purposes, only the expenses allocable to non-business use qualify for the credit.

The credit covers both the cost of the hardware and the expenses of installing it, such as labor costs for on-site preparation, assembly, and installation of the equipment and for piping or wiring to connect it to your home. You claim the credit in the year in which the installation is completed. If you install the equipment in a newly constructed or reconstructed home, you claim the credit for the year when you move in. The credit can be taken for a newly constructed home if the costs of the solar power system can be separated from the home's other construction costs and the required certification documents are available.

Solar installation companies offer a variety of ways to pay for their systems other than cash. You could take out a loan, and if that loan were secured by your home, generally you would be able to deduct the interest on the loan. Another option is to lease the system, in which case you would not qualify for the 30% solar credit and the lease payments would not be deductible. In addition, for the lease option, you would have to deal with transferring the lease to the new owner should you decide to sell the home or arrange to pay it off.

Another option available in some communities is loans financed by local government and loan payments tacked onto the property tax bill. Generally, this option is at very high interest rates, and you should consider other payment methods first. Just because the payments are added to your property tax bill does not mean the payments are deductible as property tax. Only the interest portion of the separately stated amount is deductible as home mortgage interest.

If you would like to review your options in more detail, including the tax benefits and other aspects of purchasing a solar system for your home, please give this office a call.

Tax Court Ruled Employer's Independent Contractor Interpretation Reasonable

Article Highlights:

- IRS Challenge
- Section 530 Relief
- Reasonable Basis
- Court Ruling

One of the most challenging issues facing employers is whether a worker should be classified as an employee or an independent contractor. A case recently concluded in federal district court illustrates this point. An employer, Nelly Home Care, Inc., had classified a group of 35 workers as independent contractors and was charged by the IRS with owing substantial employment taxes. The agency pursues those who try to avoid having to pay FICA, FUTA and income tax withholding by mislabeling employees in this way. Upon review of the specifics of the case, the court determined that the employer did not owe these taxes and was entitled to relief under Section 530 of the Revenue Act of 1978. The case was Nelly Home Care, Inc., DC-Pa., May 10, 2016.

The Case Against Nelly Home Care - Though the court's decision may mean that the IRS now pursues each independent contractor for self-employment taxes owed, for our purposes it is of interest to understand the terms of Section 530, the safe harbor rule on which the ruling was based. Section 530 spells out circumstances that allow a taxpayer to escape liability for paying employment taxes for a prior period — even if the case pursued by the IRS is correct and the workers should not have been classified as independent contractors. In order for Section 530 to apply, an employer needs to show that it has never treated the workers as employees, it has consistently filed all federal returns (including 1099s) and it has a reasonable basis for not treating the worker as an employee. Reasonable basis is present if any of the following can be shown:

- Having a previous judicial ruling or precedent, or technical advice, letter rulings, or a determination letter from the IRS pertaining to that business.
- Having already undergone an IRS audit that made no adjustment to the way that the workers were classified.
- Being able to show that a large percentage of businesses in the same industry follow the same practice and have done so for a significant amount of time.

Even when an employer fails to meet one of these tests, the employer can still get Section 530 relief by showing reasonable basis in some other reasonable manner. Section 530 indicates that this reasonable basis is to be construed liberally in favor of the taxpayer.

How the Court Ruled - In this particular case, the employer was in the homecare services industry, and the 35 workers in question worked with the elderly. The employer provided them with workers' compensation insurance but did not train them or control many aspects of their work. Upon review of the circumstances, the IRS determined that they were not independent contractors, but employees. However, the district court determined otherwise. Though the court indicated that the threshold had not been met for use of the statutory safe harbor, it noted that the employer had given consideration to a number of other factors that qualified Nelly Home Care for the reasonable basis safe harbor. Those factors included the fact that others in the field categorized their workers in the same way and that the personal income tax returns of the corporation's shareholders had previously undergone an IRS audit that did not raise the issue, despite the IRS having reviewed business documents involving the workers during the audit. The court ruled that these two factors were enough for the employer to have made a reasonable assumption that the practice was correct.

Though this case ended well for the employer, not all stories end so happily. Making the wrong decision can end up costing a business a significant amount of money in fines and back taxes. If you are not certain as to how to categorize your own workers, give this office a call. In some cases it may also be appropriate to seek legal advice.