Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

FALL 2015 Volume XX, Number 2

Inside This Issue:

Leslie A. Cesario, Ltd.
Certified Public Accountant
1313 Marengo Court
Naperville IL, 60564
630-691-6902
lesliec@laccpa.net

Safe-Harbor Home Office Deduction

Taxpayers can elect to take a simplified deduction for the business use of the taxpayer's home. The deduction is $5 per square foot, with a maximum square footage of 300. Thus, the maximum deduction is $1,500 per year. Here are the details of this simplified method:

Annual Election – A taxpayer may elect to take the safe-harbor method or the regular method on an annual basis. Thus, a taxpayer may freely switch between the methods each year. The election is made by choosing the method on a timely filed original return and is irrevocable for that year.

Depreciation – When the taxpayer elects the safe-harbor method, no depreciation deduction for the home is allowed, and the depreciation for the year is deemed to be zero.

Additional Office Expenses – Additional office expenses such as utilities, insurance, office maintenance, etc., are not allowed when the safe-harbor method is used.

Home Interest and Taxes – Prorated home interest and taxes are not allowed as an office expense when using the safe-harbor method. Instead, 100% of the home interest and taxes are deductible as usual on Schedule A.

Deduction Limited by Business Income – As is the case with the regular method, under the safe-harbor method the home office deduction is limited by the business income. For the safe harbor, the deduction cannot exceed the gross income derived from the qualified business use of the home for the taxable year reduced by the business deductions (deductions unrelated to the qualified business use of a home). However, unlike the regular method, any amount in excess of this gross income limitation is disallowed and may not be carried over and claimed as a deduction in any other taxable year.

Home Office Carryover – This cannot be used in a year in which the safe-harbor method is used. The carryover continues to future years and can only be used when the regular method is used.

Qualifications – A taxpayer must still meet the regular qualifications to use the safe-harbor method.

Reimbursed Employee – The safe-harbor method cannot be used by an employee who receives advances, allowances, or reimbursements for expenses related to qualified business use of his or her home under a reimbursement or other expense allowance arrangement with the employer.

Determining Square Footage – To determine the average square footage of the business, use these guidelines:

- ***Square Feet Maximum –*** Never use more than 300 square feet for any month, even if the taxpayer has multiple businesses. Where there are multiple businesses, use a reasonable method to allocate between businesses.
- ***Determining Average Square Feet for the Year –*** Use zero for months when there was no business use or when the business was not for a full year.
- ***15-Day Minimum –*** Don't count any month in which the business use is less than 15 days.

(...Cont'd on Page 3)

Preventing Tax Problems When Employees Travel

Sending employees on business trips is essential for countless companies and can result in tax headaches for both the employer and the employee if the tax regulations are not adhered to. If the rules are followed, the cost of the employee's travel will be fully deductible to the employer, with the exception of meals, which are only 50% deductible, and tax-free reimbursement to the employee. In addition, the reimbursement is not subject to FICA or payroll withholding.

On the other hand, if the rules are not followed, the expenses are still deductible by the employer, but the reimbursement must be added to the employee's taxable wages, subject to both FICA and payroll withholding.

An employer is able to deduct ordinary and necessary business expenses, including an employee's job-related travel and lodging expenses that are not lavish or extravagant, and under the rules of working condition fringe benefits, any such item that is deductible by the employer is not includible in the employee's salary. In addition, an advance or reimbursement made to an employee under an "accountable plan," which requires the employee to adequately account for the expenses and return any excess advances, is deductible by the employer and not subject to FICA or income tax withholding.

Reimbursements not made under an accountable plan are fully taxable to the employee, and the only way for the employee to deduct the expenses is as a miscellaneous itemized deduction on his or her 1040. To do that, the employee must itemize his or her deductions on Schedule A, as opposed to taking the standard deduction. The employee business expense category on Schedule A is subject to a 2% of AGI nondeductible threshold, and this frequently results in the employee not being able to deduct any or only a portion of the expenses.

With the exception noted below, to deduct the cost of lodging and meals, the taxpayer must be away from home overnight. Any trip that is of such a length as to require sleep or rest to enable the taxpayer to continue working is considered "overnight."

Under an exception to the away-from-home rule, the cost of local lodging is deductible if the lodging is necessary for the individual to participate fully in or be available for a bona fide business meeting, conference, training activity, or other business function and the duration does not exceed five calendar days and does not recur more frequently than once per calendar quarter. For an employee, the employer must require the employee to remain at the activity or function overnight, the lodging must not be lavish or extravagant, and there can be no significant element of personal pleasure, recreation, or benefit.

A taxpayer's home, for purposes of determining if he or she is away from home and can deduct lodging and meals, is generally where the taxpayer normally lives and works, although that fact is sometimes difficult to determine, in which case the IRS has numerous special rules that apply.

Where an away-from-home assignment, at a single location, lasts for one year or less, it is "temporary," and the travel expenses are deductible. If the assignment is longer, there is a good chance the expenses will not be deductible based upon some complex rules.

The rules for the tax treatment of travel expenses and temporary away-from-home assignments can be complex. Please give this office a call for further details or assistance.

Is Your Hobby a For-Profit Endeavor?

Whether an activity is a hobby or a business may not be apparent to the customers of the endeavor, but distinguishing the difference is necessary for tax purposes because the tax treatments are substantially different. The IRS provides appropriate guidelines when determining whether an activity is engaged in for profit, such as a business or investment activity, or if it is engaged in as a hobby.

Internal Revenue Code Section 183 (Activities Not Engaged in for Profit) limits deductions that can be claimed when an activity is not engaged in for profit. IRC 183 is sometimes referred to as the "hobby loss rule."

This article provides information that is helpful in determining if an activity qualifies as an activity engaged in for profit and what limitations apply if the activity was not engaged in for profit.

Is your hobby really an activity engaged in for profit? In general, taxpayers may deduct ordinary and necessary expenses for conducting a trade or business or for the production of income. Trade or business activities and activities engaged in for the production of income are activities engaged in for profit.

The following factors, although not all-inclusive, may help you determine whether your activity is an activity engaged in for profit or a hobby:

- Does the time and effort put into the activity indicate an intention to make a profit?
- Do you depend on income from the activity?
- If there are losses, are they due to circumstances beyond your control or did they occur in the start-up phase of the business?
- Have you changed methods of operation to improve profitability?
- Do you have the knowledge needed to carry on the activity as a successful business?
- Have you made a profit in similar activities in the past?
- Does the activity make a profit in some years?
- Do you expect to make a profit in the future from the appreciation of assets used in the activity?

An activity is presumed to be engaged in for profit if it makes a profit in at least three of the last five tax years, including the current year (or at least two of the last seven years for activities that consist primarily of breeding, showing, training, or racing horses).

If an activity is not for profit, losses from that activity may not be used to offset other income. An activity produces a loss when related expenses exceed income. The limit on not-for-profit losses applies to individuals, partnerships, estates, trusts, and S corporations. It does not apply to corporations other than S corporations.

Hobby deductions If it is determined that your activity is not for profit, allowable deductions cannot exceed the gross receipts for the activity.

Deductions for hobby activities are claimed as itemized deductions on Schedule A and must be taken in the following order and only to the extent stated in each of the three categories:

- Expenses that a taxpayer would otherwise be allowed to deduct, such as home mortgage interest and taxes, may be taken in full.
- Deductions that don't result in an adjustment to the basis of property, such as advertising, insurance premiums, and wages, may be taken next, to the extent that gross income for the activity is more than the deductions from the first category.
- Deductions that reduce the basis of property, such as depreciation and amortization, are taken last, but only to the extent that gross income for the activity is more than the deductions taken in the first two categories.

If you have questions related to your specific business or hobby circumstances, please give this office a call.

(Safe-Harbor Home Office Deduction Is It Better For You? Cont'd ...)

As an example, a taxpayer begins using 400 square feet of her home for business on July 20, 2015, and continues using the space as a home office through the end of the year. Her average monthly allowable square footage for 2015 is 125 square feet (300 x 5 months = 1500/12 = 125).

- ***Multiple Businesses –*** Where there are multiple businesses, only one method may be used for the year – either the regular or safe harbor.
- ***Mixed-Use Property –*** A taxpayer who has a qualified business use of a home and a rental use for purposes of § 280A(c)(3) of the same home cannot use the safe-harbor method for the rental use.

Taxpayers Sharing a Home – Taxpayers sharing a home (for example, roommates or spouses, regardless of filing status), if otherwise eligible, may each use the safe-harbor method but not for a qualified business use of the same portion of the home.

As an example, a husband and wife, if otherwise eligible and regardless of filing status, may each use the safe-harbor method for a qualified business use of the same home for up to 300 square feet of different portions of the home.

Depreciation Rate When Switching Methods – When the safe-harbor method is used and the taxpayer subsequently switches back to the regular method, use the depreciation factor from the appropriate optional depreciation table as if the property had been depreciated all along.

When choosing between the methods, the following factors should be considered:

- There is no reduction in basis for depreciation or depreciation recapture when using the safe-harbor method.
- When using the regular method, the income limitation takes into account home interest, taxes, and other expenses before allowing the depreciation portion of the deduction. That is not true for the safe-harbor method as the interest, taxes, and other business-use-area expenses are not considered.

If you have questions related to this simplified method of claiming a deduction for the business use of your home, please give this office a call.

Are Charity Auction Purchases Deductible Contributions?

It is common practice for charities to hold auction events where attendees will bid upon and purchase items. The question often arises whether the money spent on the items purchased constitutes a charitable donation.

The answer to that question is some, but not all, of what's paid for the item may be deductible. So if you purchase items at a charity auction, you may claim a charitable contribution deduction for the excess of the purchase price paid for the item over its fair market value. You must be able to show, however, that you knew that the value of the item was less than the amount you paid for it. For example, a charity may publish a catalog, given to each person who attends an auction, providing a good faith estimate of items that will be available for bidding. Assuming you have no reason to doubt the accuracy of the published estimate, if you pay more than the published value, the difference between the amount you paid and the published value may constitute a charitable contribution deduction.

In addition, if you provide goods for charities to sell at an auction, you may wonder if you are entitled to claim a fair market value charitable deduction for your contribution of appreciated property to the charity that will later be sold. Under these circumstances, the law limits your charitable deduction to your tax basis in the contributed property and does not permit you to claim a fair market value charitable deduction for the contribution. Specifically, the Treasury Regulations (Sec 170) provide that if a donor contributes tangible personal property to a charity that is put to an unrelated use, the donor's contribution is limited to the donor's tax basis in the contributed property. The term unrelated use means a use that is unrelated to the charity's exempt purposes or function. The sale of an item is considered unrelated, even if the sale raises money for the charity to use in its programs.

Please contact this office for additional information.

Only One IRA Rollover Every 12 Months – Period!

Although this subject has been brought up before – and, yes, we are harping on the subject because of the profound tax consequences – this is a reminder that, beginning this year, individuals are only allowed one IRA rollover in any 12-month period (this includes SEP and Simple accounts, traditional and Roth IRAs). That is, 12 months must have elapsed from the date a rollover is completed before another rollover can be made. Failure to abide by this rule can be expensive. And the rule applies no matter how many IRAs an individual owns.

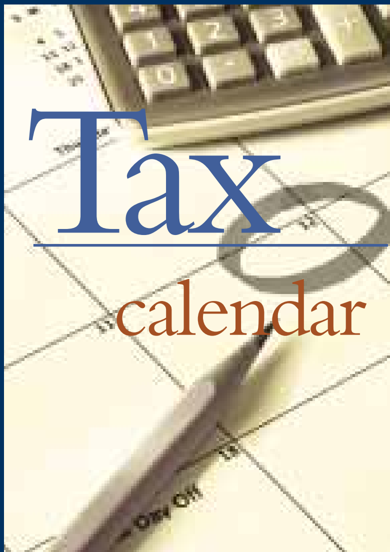
Example – *Joe makes an IRA rollover on March 1, 2015. He cannot roll over another IRA distribution, without penalties, until March 2, 2016.*

If Joe, in the example, were to make another IRA rollover before March 2, 2016, that entire distribution would be treated as a taxable distribution and would also be subject to the 10% early distribution penalty if Joe is under the age of 59.5 at the time of the distribution. Additionally, if Joe deposited the distributed amount into another IRA, or redeposited the funds into the same IRA, those funds are treated as an excess contribution and are subject to a 6% penalty per year for as long as they remain in the IRA.

That doesn't mean you can't transfer funds between IRA trustees multiple times during the year. In a rollover, a taxpayer takes possession of the funds and then must redeposit them within 60 days to avoid being taxed on the distribution. In contrast, a transfer moves the funds directly from one trustee to another with the taxpayer never taking possession of the funds. Unlimited direct transfers are allowed, including moving traditional IRA funds to a Roth IRA (called a conversion).

If, through no fault of yours, a trustee does not follow your instructions to make a transfer and instead distributes the funds to you, procedures are available to obtain relief.

If you are planning an IRA rollover, before taking the distribution, please check with your IRA trustee or call this office to ensure you are not violating the 12-month rule.



Tax calendar

Sept. – Dec. 2015

September – December:
- Time for your autumn 2015 and 2016 tax planning. Contact this office to schedule a consultation appointment.

September 15, 2015:
- The third installment of 2015 individual estimated taxes is due.
- This is the FINAL extended filing due date for your 2014 calendar year partnership returns (Form 1065), fiduciary returns (Form 1041), S corporation returns (Form 1120S), and corporation returns (Form 1120).

October 15, 2015:
- This is the FINAL extended filing due date for your 2014 individual income tax return.

December 31, 2015:
- This is the last day for taxpayers who began their minimum IRA distributions prior to 2015 to make their required withdrawals for 2015. However, to allow IRA trustees/custodians ample time to process distribution payments, taxpayers should request distributions well ahead of this date.
- This is generally the LAST day that you can pay tax deductible expenses for the year. IRA contributions and some self-employed retirement plan contributions can be made after the close of the year.

Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

Leslie A. Cesario, Ltd.
Certified Public Accountant
1313 Marengo Court
Naperville IL, 60564
630-691-6902
lesliec@laccpa.net

Since You Asked...

You Asked: I use public transportation to and from work. The commute is about one hour each way. I carry my laptop and cell phone with me and work during the entire commute. A friend of mine said that since I am working during the commute, the cost of the transportation is deductible. Is that true?

Answer: The key word here is "commute." Unfortunately, your friend has given you inaccurate information. Per the IRS' rules for local transportation, the cost of traveling to and from work (commuting) is not deductible, even if you are working while traveling.

You Asked: I recently replaced the computer system at the office of my unincorporated business, and I plan to donate the old system to a charity. How do I determine the amount of my charitable deduction?

Answer: You may or may not have a deduction. Assuming your use of the computer was all business, you would have been writing off the cost of the computer by depreciating it, or would have expensed it under the special Sec 179 expense allowance in the year it was purchased. Keep in mind, a taxpayer can't deduct something twice, so if it was already written off for business then there are no further deductions available for the cost of the computer. If you haven't completely written it off then you can scrap it and take the remaining value as a loss from the disposition of a business asset on your tax return, but not as a charitable contribution, which must be taken as an itemized deduction. Regardless of how the computer is disposed of, remember that a computer's hard drive may contain some sensitive information that should be deleted prior to disposition.