Taxes for Real Estate Professionals

Integrity in Tax & Accounting 920-277-2991 www.integrityintaxllc.com

August 2018 ~ WiscoREIA

By Tina M. Kleckner EA, CAA

Extensions Coming Due!

Due date for business tax returns, such as partnerships and S-Corps, is Sept. 17. Individual tax extensions are due Oct. 15.

Veterans – Does the IRS owe you a Refund?

Disabled Veterans who received disability severance payments after January 17, 1991, and included that payment as income should file an Amended Tax Return to claim a credit or refund of the overpayment of tax attributable to the disability severance payment.

The Department of Defense has sent letters in July to nearly 130,000 eligible Veterans. Those who have received a letter have one year from its date to claim a refund.

FREE REVIEW PRIOR

2 YEARS TAX RETURNS!

920-277-2991

Prior Month's Newsletters

are available on our website at www.integrityintaxllc.com – click on Real Estate Professionals.

To receive an email each month with the Newsletter, email us at info@integrityintaxllc.com.

Standard Mileage Rates 2018

Business = $0.545

Medical = $0.17

Charity = $0.14

Tax Reform

* Standard Deduction:
$12,000 Single
$24,000 Married Filing Joint
$18,000 Head of Household

* Personal Exemption is eliminated for Tax Years 2018 - 2025.

* Child Tax Credit:
Increase to $2,000 per child under age 17. Dependents over age 17 may qualify for $500 credit.

Address:
5733 W. Grande Market Drive, Ste. E
Appleton, WI 54913
920-277-2991

S-Corporate Shareholder Compensation

Once S-Status is elected, owners become Shareholders of the business. Shareholders who provide services to the corporation are employees of the corporation and their compensation is subject to payroll taxes. The question is commonly asked "How much should I be paid?" Seems like a relatively easy question to answer – right? Oh, no, this question is anything but easy to answer and has been the topic of many court discussions over the years that we think it is worth reviewing annually. There is no rigid set of rules for measuring the reasonableness of compensation. No definition of "reasonable" is contained in the Internal Revenue Code; the regulations provide only that reasonable compensation is an amount paid for like service by like businesses under like circumstances. Court cases have shown, however, that each situation must be resolved based on its unique facts and circumstances. Some Tax Court decisions have focused on the following:

1. Character and financial condition of the corporation;
2. Role the shareholder plays in the corporation, including the employee's position, hours worked, and duties performed;
3. Corporation's compensation policy for all employees and the shareholder's individual salary history including the corporation's internal consistency in establishing the shareholder's salary;
4. How the compensation compares with similarly situated employees of similar companies;
5. Conflicts of interest in setting compensation levels; and
6. Whether a hypothetical independent investor would conclude that there is an adequate return on investment after considering the shareholder's compensation.

The courts have also considered additional factors in deciding whether the amount of compensation is reasonable, including these:

1. Employee's qualifications;
2. Size and complexity of the business;
3. Comparison of salaries paid to sales and net income;
4. General economic conditions;
5. Comparison of salaries to shareholder distributions and retained earnings;
6. Corporation's dividend history;
7. Whether the employee and employer dealt at arms' length;
8. Corporate intent; and
9. Whether the employee guaranteed the employer's debt.

We recommend Shareholder compensation should be comparable to that of what the business would pay an outside, third party person to perform the same tasks and duties. This information can be found by searching www.indeed.com for positions that closely resemble the Shareholder's position in the same area. Print a copy of the job description, position, and pay to keep with the business records that can be used to substantiate compensation if questioned.

Remember: The better the documentation kept by the business, the more likely that the compensation will withstand IRS attack.

Paying a Year-End Bonus

Menards, a retail home improvement chain operating as a C corporation, paid its founder and president a bonus of 5% of the company's net income before income taxes. This resulted in a $17,467,800 bonus for the tax year at issue, which the Tax Court found to be excessive and to look more like a dividend than a bonus. In upholding the bonus, the 7th Circuit noted that dividends typically are specified as so many dollars per share rather than a percentage of earnings. Although tying compensation to the market value of the company's stock has been criticized because of factors besides managerial effort and ability that influence the price of a publicly traded stock, stock in Menards (like stock in S corporations) is not publicly traded. Furthermore, the fact that the bonus was paid at the end of the year was of no consequence because net income for the year was not determinable until the close of the last day of the year on which the chain's stores were open. As a practical matter, bonuses are usually paid in a lump sum once a year, often at Christmas, although that would not be feasible unless Menards closed its stores the following week.

In short, if your S-Corp pays Shareholders a bonus, be sure to structure the payment as such and keep detailed documentation.

Tax Reform

The Tax Cuts and Jobs Act, also known as TCJA, was signed into law by the President on Dec. 22, 2017. This new tax law includes many provisions that affect individuals and businesses. Each month, we will explain at high level one provision that affects individual tax returns and one provision that affects businesses.

Individual: Notice that on page 1 of this newsletter on the right side, we have a few highlights of the TCJA that will affect just about every individual tax return filed in 2019.

Alimony: For divorce or separation agreements executed after Dec. 31, 2018, payments are not deductible by the paying spouse and not included as income by the receiving spouse. Rather, income used for alimony payments is taxed at the rate of the paying spouse.

However, divorce or separation agreements dated before Dec. 31, 2018 appear to be treated under the old law of deducting by the paying spouse and including as income by the receiving spouse.

This provision is effective for divorce or separation agreements dated after Dec. 31, 2018 and appears to be permanent.

Business: The TCJA has increased Sec. 179 expensing, as well as expanding the definition of Qualified Real Property. As a business owner, you are familiar with the election to expense the cost of qualifying property, rather than to recover such costs through depreciation deductions. This election is known as Sec. 179 expensing.

Qualifying property is depreciable tangible personal property that is purchased for use in the active conduct of a trade or business and qualified real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

Sec. 179 amounts are increased from $500,000 to $1 million with phase-out threshold amount increased to $2.5 million for property placed in service after Dec. 31, 2017. After 2018, these amounts are indexed for inflation.

This provision also expands the definition of Qualified Real Property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging such as hotels. Qualified Real Property also includes improvements to nonresidential real property such as roofs, heating, ventilation, and air-conditioning property, fire protection and alarm systems, and security systems.

1031 Like-Kind Exchanges Applies to Only Real Property:

The TCJA has a provision that updates the Sec. 1031 Like-Kind Exchanges to apply only to exchanges of real property. Thus, effective January 1, 2018, exchanges of machinery, equipment, vehicles, artwork, collectibles, patents and other intellectual property and intangible business assets generally do not qualify for non-recognition of gain or loss as like-kind exchanges. However, certain exchanges of mutual ditch, reservoir or irrigation stock are still eligible for non-recognition of gain or loss as like-kind exchanges.

Rehabilitation Credit:

TCJA also impacts the Rehabilitation Tax Credit for amounts paid or incurred for qualified expenditures after December 31, 2017. The credit is a percentage of expenditures for the rehabilitation of qualifying buildings in the year the property is placed in service.

The new legislation:

- Requires taxpayers take the 20-percent credit ratably over five years instead of in the year they placed the building into service, and
- Eliminates the 10 percent rehabilitation credit for the pre-1936 buildings.

A transition rule provides relief to owners of either a certified historic structure or a pre-1936 building by allowing owners to use the prior law if the project meets these conditions:

- The taxpayer owns or leases the building on January 1, 2018 and at all times thereafter, or
- The 24- or 60-month period selected for the substantial rehabilitation test begins by June 19, 2018.

In Summary, these provisions of the TJCA are favorable to small business owners when it comes to tax time. **Don't overlook these deductions!**

• • •

LIKE US ON facebook

Have a Tax Question?

Submit your questions to: info@integrityintaxllc.com with WiscoREIA in the subject line.

Blog

Tina's Blog can be found on our website at www.integrityintaxllc.com – click on Tina's Blog.

Commonly Missed Credits & Deductions

A couple of the most common missed credits and deductions we find when reviewing prior year tax returns are:

1. Self-employed health insurance deduction is missed. This deduction includes the amount that is paid out-of-pocket for health insurance. It also includes Medicare premiums (including Parts A, B, C, and D) paid by the self-employed. Individuals who did not claim self-employed health insurance deductions for Medicare premiums on prior returns for years that are still open may file amended returns to claim the deduction (CCA 201228037).

2. Education credits of students with parents that have higher incomes are often overlooked. This is because the parents' income is too high and therefore phases-out the education credits. However, the student may be able to claim the education credits on their tax return. To do this, the student will need to claim themselves on their own tax return, therefore coming off the parents' tax return as a dependent. If the parents' income is at a level where the deduction for dependency exemptions is phased out, forgoing the dependency exemption for the child does not materially impact their tax liability. The student must also have sufficient income to generate enough tax liability to utilize the education credit. If the student's health insurance is provided through the family coverage, we caution parents to check the provisions of their family health insurance coverage before using this strategy as some policies may require children be claimed on the parents' tax return in order to be covered under the insurance policy.

3. Depreciation on rental property is not taken. It is very common for a client to have one or two rental properties in addition to their full-time job. Upon review of their prior year's tax returns, it is also very common for us to find depreciation was not taken on the rental property. The primary reason is the client not knowing or understanding how to take the deduction and the impact on the overall tax return. Missed depreciation is corrected on the current year tax return by attaching Form 3115.

Yes, we provide a FREE review of your past two years tax returns. All you have to do is call us at 920-277-2991 or email Tina at tinak@integrityintaxllc.com. You don't even need to come to our office. You can upload your prior year's tax returns right to our secure client portal on our website.

• • •

WiscoReia Members!

WisccoReia Members that use our services will receive an initial $25 Home Depot or Kwik Trip gift card. Members can earn additional gift cards to Home Depot or Kwik Trip for referrals of those who become our clients.

• • •

• • •

Social Media

Please Like and Follow us on Social Media!

Recent Court Cases

IRS Can Rely on County Assessments to Allocate Real Estate Costs: The taxpayers owned several rental properties in California.

To calculate their depreciation deduction for the year at issue, the taxpayers incorrectly included the cost of both the land and the buildings. The IRS disallowed the portion of the deduction attributable to the land based on information from the Los Angeles County Office of the Assessor. The taxpayers disputed this approach, claiming that the county assessments were extraordinarily inaccurate and internally inconsistent. The Tax Court disagreed, finding that the county's allocations were reliable and persuasive. Therefore, the IRS's reliance on this information was proper. Sharon and Steve Nielsen , TC Summ. Op. 2017-31 (Tax Ct.).

Home Office Deduction Denied for Document Storage in Garage: The taxpayer owned a smog inspection station in California. By law, he was required to keep certain invoices and records regarding smog checks for at least three years. Because the station lacked office space, the taxpayer stored the inspection invoices and other business-related items in a shared two-car garage attached to his personal residence.

On his federal income tax returns for the years at issue, the taxpayer claimed home office expense deductions for the use of his garage. He argued this was the most convenient and inexpensive place to store the records. The IRS disallowed the deductions under IRC Sec. 280A(a). The Tax Court sided with the IRS, finding that the taxpayer's garage wasn't used exclusively as his principal place of business. Also, he didn't qualify for an exception that pertains to the storage of inventory or product samples that are sold at retail or wholesale. *Mohammad Najafpir* , TC Memo 2018-103 (Tax Ct.).

Joint Returns Valid Despite Wife's Forged Signature: For the years at issue, the taxpayer's husband filed joint returns and paid all federal income taxes due. However, he signed the returns on the taxpayer's behalf without her knowledge or consent. After her husband's death, the taxpayer filed separate returns for the years at issue and sought a refund of part of the taxes her husband paid. She claimed the joint returns were invalid due to the forged signatures. A North Carolina District Court disagreed, holding that when only one spouse signs a joint return, that return is valid if the nonsigning spouse intended to file jointly. The taxpayer knowingly left all tax matters up to her husband and understood that he prepared and filed joint returns on her behalf. Therefore, she was precluded from replacing the valid joint returns with separate returns that showed a smaller tax liability. *Alice Coggin,* 122 AFTR 2d 2018-XXXX (DC NC).