Taxes for Real Estate Professionals

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

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Tax Deadline – Sept. 17!

Business tax returns, such as S-Corp and Partnerships and 3rd Quarter estimated tax payments are due Sept. 17, 2018.

WI Sales Tax – Oct. 1

Beginning October 1, 2018, Wisconsin will require online sellers to collect and remit sales or use tax on sales of taxable products and services in Wisconsin. New standards for administering sales tax laws on online sellers will be developed by rule. The rule will be consistent with the Court's decision in *Wayfair*, which approved a small seller exception for sellers who do not have annual sales of products and services into the state of (1) more than $100,000, or (2) 200 or more separate transactions.

Don't wait until it's too Late!

START TAX PLANNING NOW!

920-277-2991

Prior Month's Newsletters

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

Would you like to receive this Newsletter by email each month? Email us at info@integrityintaxllc.com to be added to our distribution list.

Standard Mileage Rates 2018

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Business = $0.545

Medical = $0.17

Charity = $0.14

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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.

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Note: Any small seller exception adopted will not apply to sellers with a physical presence in Wisconsin.

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Check Your Expenses

To be deductible, a business expense must be both **ordinary and necessary**. An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your trade or business. An expense does not have to be indispensable to be considered necessary.

Deductible business expenses differ by industry. Unfortunately, the IRS does not produce a list of acceptable business expenses that are deductible.

As the year-end approaches, we recommend being proactive and reviewing your business expenses to be sure they meet the ordinary and necessary requirements.

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Per Diem Rates Released

The General Services Administration (GSA) has released the federal domestic per diem rates for fiscal year 2019. The IRS permits taxpayers to use these rates to substantiate business expenses for lodging, meals, and incidental expenses incurred while traveling away from home. The maximum standard per diem rate has increased from $144 to $149 ($94 for lodging and $55 for meals and incidental expenses). Per diem rates for localities without standard rates range from $149 to $470 (with Vail, Colorado having the highest rate). The updated rates are effective from 10/1/18 through 9/30/19.

The per diem rates can be found at https://www.gsa.gov/travel/plan-book/per-diem-rates.

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Safe Harbor Relief for Misclassified Workers

Are your workers independent contractors or really employees? It is common for small businesses to treat all workers as independent contractors. But will this get you in trouble with the IRS? First let's, look at the IRS definition of each.

Independent contractors generally have the ability to control what work will be done and how the work is done. The business only has the right to control or direct the result of the work that is to be done. On the other hand, employees are generally told what work is to be done and how it is to be done. The business controls the details of the work performed by the workers.

Many small businesses misclassify their workers as independent contractors when they might really be employees. The IRS generally looks at three factors in determining whether a business has independent contractors or employees. These are behavioral control, financial control, and relationship of the parties involved.

Behavior control focuses on whether the business directs or controls how the workers perform each task. The existence of procedures and training manuals may indicate

the workers are employees. Whereas, the absence of these manuals may indicate the workers control what work is done and how it is done, hence, suggesting workers are independent contractors.

Financial control focuses on whether the business directs or controls how the activities of the workers are conducted. Reimbursement of expenses and method of payment are items that may be used to determine whether workers are independent contractors or employees. For instance, if the workers invoice the business, this suggests more of an independent contractor status than an employee.

The last factor that is considered is the relationship of the parties. This focuses on how each party (the business and workers) perceives the relationship. A written contract may indicate the workers are independent contractors whereas employee benefits may suggest workers are employees.

To determine whether the control test is satisfied in a particular case, all three of the above factors must be analyzed. The significance given to a particular category of evidence will depend on the particular facts and circumstances and can change over time. For example, requiring workers these days to wear a particular uniform may have less to do with control over the worker and more to do with assuring customers that the worker can be safely allowed into their home or business. IRS officials have publicly stated that the right to control the worker and the worker's opportunity for profit and risk of loss are the most significant, although not determinative, factors.

Generally, the IRS applies a 20-factor common law control test in a fair and consistent manner in determining whether workers are independent contractors or employees that focuses on the above three factors, behavioral control, financial control, and relationship of the parties.

However, the IRS does acknowledges the uncertainty that underlies the application of the common law rules and emphasizes the critical need for a facts-and-circumstances analysis of the relationship between the business and the workers. The degree of importance of each category of evidence varies depending on the occupation and the factual context in which the services are performed. Any single factor or a small group of factors is not conclusive evidence of the presence or absence of control. The workers do not have to meet all (or even most) of the elements to be independent contractors or employees. No one factor is controlling. Some factors are not present in every case, and some factors do not apply to certain occupations. Because of this, the IRS's categories of evidence analysis are only a starting point. It is still important to locate specific cases and rulings with facts and issues on point with

respect to the business's similarly situated workers.

Businesses can request the IRS to determine whether the workers are independent contractors or employees by completing Form SS-8. The IRS will then issue a determination letter to the business regarding the worker's status as independent contractors or employees.

Note: The determination applies only to the workers or class of workers for which the determination is requested and is binding on the IRS if there is no change in the facts or law on which the determination was based.

There is a little known code contained in the Internal Revenue Code (IRC) of the IRS referred to as Section 530 Relief which is designed to provide safe harbor relief against an unanticipated reclassification of workers by the IRS. However, it contains some detailed restrictions and traps. Many businesses will fail these requirements unless they specifically plan to comply prospectively on a year-to-year basis.

Section 530 Relief generally applies to businesses that consistently misclassify workers. Consistency in treatment and information reporting is the key. Thus, a business that wants to use the Section 530 Relief rules to classify workers must be aware of the importance of consistent treatment across the years and throughout the ranks of workers holding substantially similar job positions. Treating even one worker in an inconsistent manner (i.e., as an employee) can eliminate Section 530 Relief treatment for all workers within the same class, and failing to file Form 1099-MISC for workers can prevent Section 530 Relief treatment for workers for that year.

Section 530 Relief is available only if the business meets the following requirements:

1. Files all information returns (Form 1099-MISC) for the workers or classes of workers at issue for the current year.
2. Has not and will not treat the workers as employees on income tax returns, payroll tax returns, or other returns filed by the business during the year.
3. Has a reasonable basis for treating the workers as independent contractors.

In summary, it is always best for businesses to classify workers appropriately by taking into account the IRS factors of behavior control, financial control, and relationship of the business to the workers. However, in practice many businesses have always treated workers as independent contractors, therefore, Section 530 Relief may apply if worker classification is challenged by the IRS and the above requirements have been met.

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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.

Moving Expenses: Moving expenses incurred to move for employment that is 50 or more miles away from your home is no longer tax deductible. Members of the Armed Forces on Active Duty may still claim this deduction.

This provision is effective January 1, 2018 – December 31, 2025.

Business: The TCJA has modified the NOL deduction. Previously, a Net Operating Loss (NOL) could be carried back 2 years or carried forward 20 years to offset taxable income. For NOL's beginning January 1, 2018, the 2 year carryback is repealed except for certain losses related to farming. However, the NOL's can be carried forward indefinitely. The annual NOL deduction is limited to 80% of taxable income. Carryovers to other years are adjusted to take into account this limitation.

This provision appears to be permanent.

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Recent Court Cases

Sixth Circuit Court Upholds Section 530 Relief: In *Peno Trucking, Inc. v. Commissioner* (6th Cir. Oct. 3, 2008), the United States Court of Appeals for the Sixth Circuit reversed a United States Tax Court's determination and held that the company was entitled to the protections of Section 530 of the Revenue Act of 1978 despite having misclassified its drivers as independent contractors. The case is significant because it reaffirms the right to Section 530 tax relief based on a reasonable reliance upon the common law independent contractor factors, even if those factors are established by a state agency or court.

In *Peno Trucking,* the company had a contract with another company to lease tractor-trailers and to provide drivers to operate those tractor-trailers in Ohio. Under the lease agreement, the company provided drivers to operate the trucks and was responsible for their work.

The company in turn contracted with each driver under an agreement that expressly stated they were independent contractors. It issued the drivers IRS Form 1099s each year consistent with its treatment of the drivers as independent contractors.

The IRS reclassified the drivers as employees and issued an assessment, which the company challenged in Tax Court. The company asserted that the drivers were properly classified, but even if they were not, the company met the requirements for Section 530 relief. The Tax Court ruled in favor of the IRS on the worker status issue, finding that the company, rather than the drivers, had a substantial investment in the tractor-trailers, the drivers' services were continuous in nature and essential to the company's business, the drivers really could not realize a profit or loss, and the company controlled the driver's responsibilities, work hours and loads hauled. On appeal, the Sixth Circuit affirmed the determination that the drivers were employees and not independent contractors.

The company had also argued that it was entitled to relief under Section 530, and on that basis was not liable for employment taxes. There are three requirements that an employer must satisfy to be able to obtain Section 530 relief. The employer must have:

1. Consistently treated the workers (and similarly situated workers) as independent contractors;

2. Complied with the Form 1099 reporting requirements with respect to the compensation paid the workers for the tax years at issue; and

3. Had a reasonable basis for treating the workers as independent contractors.

The first two criteria were not at issue. The company argued that it satisfied the third criterion because the Ohio Industrial Commission (OIC) and Bureau of Workers' Compensation (BWC) ruled on two occasions that the drivers were independent contractors. The Tax Court rejected this argument, stating that, in order for a judicial precedent to be a reasonable basis, it must be evaluated using the federal common law test. The Tax Court found that there was no evidence that either the OIC or the BWC had applied the federal common law when determining that the company's drivers were independent contractors, and therefore the company's reliance upon those decisions could not meet the reasonable basis criteria.

The Sixth Circuit rejected the Tax Court's analysis. The court first noted that, if the company established a prima facie case that it met all three criteria, the burden shifted to the IRS to prove otherwise. The court found that the first two criteria of Section 530 were met because the company had always treated the truckers in question as independent contractors, and the company had always filed its tax returns in a manner consistent with this treatment. It then rejected the Tax Court's interpretation of the reasonable basis criterion. The Sixth Circuit found that the law applied by the OIC and the BWC appeared to be virtually identical to the federal common law 20-factor test. Based on the finding that the state agencies employed a common law test virtually identical to the federal common law test, the court ruled that the determinations of the OIC and BWC were reasonable judicial precedents upon which the company could rely. The court added that "at oral argument the Commissioner could not point to another jurisdiction in the United States that uses a test for differentiating between employees and independent contractors at odds with typical common-law test. Thus, much of the Commissioner's argument stands on shaky ground." It thus concluded that the company's "reliance on the official determinations of the OIC and BWC would seem to satisfy the reasonable basis requirement."

Having determined that the company established a prima facie case, the Sixth Circuit then found that the IRS had failed to present evidence demonstrating that the company had ever treated the workers as other than independent contractors. Accordingly, because the burden of proof had shifted to the IRS upon the showing of a prima facie case, and the IRS failed to meet that burden, the Sixth Circuit held that the company was entitled to Section 530 tax relief.

The results of this case are highly favorable for taxpayers. Those states that use the common law test for state employment taxes generally are in near complete accord with the federal common law. Thus, in those states, a decision before a state administrative agency or state court that is favorable to the taxpayer on a worker's status may be used to demonstrate that such decision provides a reasonable basis for the treatment of the workers as independent contractors under an application of the law that is substantially the same as the federal common law. By recognizing the reality of the similarities in the law, taxpayers may be provided with additional grounds to support the reasonableness of their

classification. (William Hays Weissman; https://www.littler.com/sixth-circuit-upholds-section-530-relief-trucking-company-treated-drivers-independent-contractors).

Waterproofing Business Workers Re-classed to Employees: In Juan *Ramirez v. Commissioner T.C. Summary Opinion 2007-346*, J.R. Waterproofing operated as a sole proprietorship in which the regular course of business generally provided waterproofing services of decks, shower stalls, and stairways. The business had three workers that were paid as independent contractors. The duties of the workers' involved picking up materials for a job, transporting materials to a job site, cleaning and preparing the surface of a job site, cutting stucco, providing flashing, installing drains, laying burlap and fiberglass, and installing mastic and several coats of waterproof materials. The business controlled each job site, delegated responsibilities, and directed each of the worker's actions. Although the workers often used their own tools to perform jobs, the business provided all materials for each job and reimbursed the workers for expenses incurred on each job. J.R. Waterproofing maintained three trucks which the workers often used to drive to various job sites and perform their duties. J.R. Waterproofing also provided workers with cellphones. The workers were usually paid a standard amount weekly. The workers were paid this standard amount even if there was a lack of work during a week that caused the workers to work less. The business filed Forms 1099-Misc to each worker. Upon review of the facts and circumstances, the Tax Court concluded the workers were employees rather than independent contractors. J.R. Waterproofing did not have a reasonable basis for treating workers as independent contractors rather than employees, and thus fails the third test (see above Sec. 530 Relief Requirements, page 4). J.R. Waterproofing presented no judicial precedent, published ruling, technical advice, or letter ruling that was relied upon in treating workers an independent contractors. Therefore, Tax Court concluded no reasonable basis for failing to characterize workers as employees.

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Have a Tax Question?

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