HOW WE ADVISE CLIENTS

Client advisor

CURRENT INFORMATION, NEWS AND TRENDS

FALL 2016 Volume XX, Number 2

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Short-Term Rental, Special Treatment

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 rental activities.

Tax Breaks for Hiring Your Children in Your Family Business

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.,

Don't Miss Out on the Electric Vehicle Credit

If you are thinking of purchasing a new car or light truck (one that weighs less than 14,000 pounds), you should consider one of the many electric vehicles currently being offered for sale so as to take advantage of a federal income tax credit that is worth as much as $7,500.

The tax credit is actually made up of two parts: a base amount of $2,500, which requires the electric vehicle to have a battery with at least 5 kilowatt-hours of capacity, and an additional $417 of credit for each kilowatt-hour of battery capacity in excess of 5 kilowatt-hours. The total amount of credit allowed for any qualified vehicle is limited to $7,500.

However, the credit will begin to be phased out for each manufacturer's vehicles when that manufacturer has sold at least 200,000 qualifying vehicles for use in the United States.

You can usually rely on the information that a dealer provides. However, to be on the safe side, you can verify which vehicles qualify for the credit and the amount of credit that is available based on the vehicle's battery capacity and the reductions due to the credit phase-out. To do so, visit IRS.gov and enter "electric car" in the search box.

To be eligible for the credit, you must be the vehicle's original user, and you must operate the vehicle predominantly in the United States.

The credit is available regardless of the vehicle's use (business, personal or a combination). The prorated portion of the credit that applies to business use becomes part of your general business credit. Any amount not used on your return for the year of purchase can be carried back to the previous year and then carried forward until it is used up (but for no more than 20 years).

What a Dealer May Not Tell You – The portion of the credit that is not treated as a general business credit (i.e., the personal use portion of the credit) is nonrefundable. Thus, it can only be used to offset your tax liability for the year when you purchase the vehicle; any excess credit is lost.

If you wish to verify your tax benefit from the credit before proceeding with a purchase, please give this office a call.

Solar Tax Credits – Before You Take the Leap

When you see TV ads for home solar power, you may get the impression that Uncle Sam is going to pick up 30% of your cost and that 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. However, the federal credit is nonrefundable and can only be used to offset a tax liability; any excess is carried over to future years (as long as the credit still applies). Currently, the credit is allowed through 2021. What this means is that you may not be able to claim the entire credit in the first year.

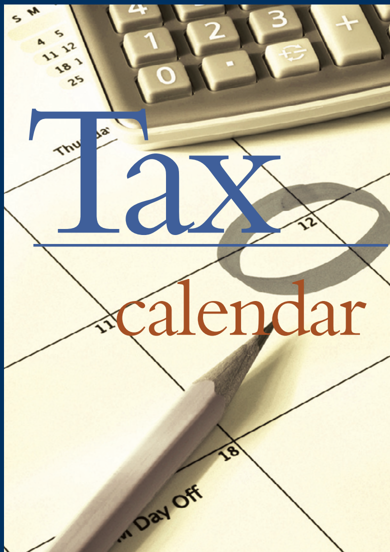
To qualify for the credit, the equipment must be installed in a home that you reside in and that is located in the U.S. The credit can't be claimed for equipment that is used to heat a swimming pool or hot tub.

The credit covers both the cost of the hardware and the expenses related to installing it. 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 in which you move into that home. The credit can be taken for a newly constructed home only if the costs of the solar power system can be separated from the home's other construction costs and if the required certification documents are available.

Solar installation companies offer a variety of noncash methods of paying for their systems. You can take out a loan, and if that loan is secured by your home, you generally can deduct its interest. Another option is to lease the system; in this case, you will not qualify for the 30% solar credit, the lease payments will not be deductible, and if you decide to sell the home, you will have to either transfer the lease to the new owner or pay it off.

In some communities, local governments may finance loans by tacking payments onto a property tax bill. However, even if the payments are added to your property tax bill, those payments are not deductible as property tax. Only the interest portion of the separately stated amount is deductible (as home mortgage interest). Generally, the local government financing option is available only at very high interest rates, so you should consider other payment methods first.

If you would like to review your options in more detail, please give this office a call.



Tax calendar

Sept. – Dec. 2016

September – December:
- Time for your autumn 2016 and 2017 tax planning. Contact this office to schedule a consultation appointment.

September 15, 2016:
- The third installment of 2016 individual estimated taxes is due. This is the FINAL extended filing due date for your 2015 calendar year partnership returns (Form 1065), fiduciary returns (Form 1041), S corporation returns (Form 1120S), and corporation returns (Form 1120).

October 17, 2016:
- This is the FINAL extended filing due date for your 2015 individual income tax return.

December 31, 2016:
- This is the last day for taxpayers who began their minimum IRA distributions prior to 2016 to make their required withdrawals for 2016. 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.

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Since You Asked...

You Asked: **I recently lost my job of several years and would like to go back to college and get my degree. My parents are willing to help me out financially but are concerned about the federal gift tax implications.**

Answer: Generally gifts in excess of $14,000 per year are subject to gift tax reporting. However, expenses your parents pay directly to the college for tuition and to providers for medical care, not by reimbursing you, are excluded from gift taxation. Thus they could pay your tuition and medical expenses plus give you up to $14,000 a year without any gift tax implications. In addition, if your gross income for 2016 is less than $4,050, your parents may be able to claim you as a dependent for the year, in which case they would be able to claim your exemption, tuition credit and possibly your medical expenses. Otherwise you would claim the tuition credit.

You Asked: **I was looking at my tax return and noticed I paid no tax on my gain from the sale of some stock that I sold. Although I like the result, will I be hearing from the IRS?**

Answer: There is a zero long-term capital gains (LTCG) rate to the extent that your regular tax rate is less than 25%. So apparently your regular tax rate was less than 25% and as a result you paid no tax on your LTCG. In the future, remember that the gain itself adds to your income, impacts income-based limitations, and possibly pushes you into a higher regular tax bracket, so it is a balancing act to take advantage of this zero rate.

You Asked: **I'm self-employed and pay my own medical insurance premiums. Can I take the cost of the insurance as a business deduction on my Schedule C?**

Answer: Although you cannot take a deduction on Schedule C, self-employed individuals are allowed to take a deduction against gross income for 100% of the medical insurance premiums paid during the year, but not to exceed the profit from your business.

You Asked: **I travel a lot by car in my business. I occasionally get a traffic citation and parking tickets. Can I deduct those costs? They are related to my business.**

Answer: I'm afraid not. The tax code specifically precludes a deduction for fines or penalties paid to a government, whether it is local, state or federal, and this applies to both foreign and domestic government entities. Even though many such costs are incurred during business trips, they are not considered deductible.