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President Trump's FY 2018 Tax Reform Proposals

Since taking office in January, President Trump has called for comprehensive tax reform. The President's recently released fiscal year (FY) 2018 budget outlines some of his key tax reform principles. At the same time, White House officials said that more tax reform details will be released in coming weeks. These details are expected to describe rate cuts for individuals and businesses, new incentives for child and elder care, elimination of certain deductions and credits, and more.

Tax measures

The President's FY 2018 budget highlights a number of tax reform proposals, leaving details for later. The President called for tax reform that lowers individual tax rates, expands the standard deduction, and protects homeownership, charitable giving and retirement saving. The FY 2018 budget also urges Congress to repeal the alternative minimum tax (AMT), the federal estate tax, and the net investment income (NII) tax. The President's FY 2018 budget also highlights some business tax proposals, including lower rates for corporations and other business entities. To offset the cost of lower rates, unspecified business tax expenditures would be repealed.

Note. Federal law requires that every budget list all tax expenditures. Generally, a tax expenditure is any item that causes a loss of revenue due to a special exclusion, exemption, or deduction from gross income, a special credit, a preferential rate of tax, or a deferral of tax liability. The FY 2018 budget lists more than 160 tax expenditures.

Health care and taxes

The Affordable Care Act (ACA) created the NII tax and a number of other new taxes. The President's budget assumes the ACA will be repealed and replaced with the American Health Care Act (AHCA). As passed by the House in April, the ACHA repeals the NII tax, the additional Medicare tax, the excise tax on medical devices, and more. The Senate is currently debating the AHCA.

Funding the IRS

Earlier this year, President Trump proposed to reduce the IRS's funding and this is reflected in the FY 2018 budget. However, in past years, Congress has restored some of the proposed funding cuts to the IRS. Last year, Congress gave the IRS an additional $290 million with instructions to use the funds for taxpayer services and to curb tax-related identity theft. Additionally, President Trump proposed giving the IRS more authority to correct errors on taxpayer returns. The FY 2018 budget also urges Congress to expressly grant the IRS authority to regulate return preparers.

Family leave

President Trump also proposed to create a new benefit within the Unemployment Insurance (UI) program. This new benefit would provide up to six weeks paid leave to mothers, fathers, and adoptive parents.

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Anticipated Tax Cut Accelerating Debt Limit Showdown

President Trump promised tax cuts during his election campaign last year and has reiterated those promises in recent months leading some wealthy Americans and businesses to shift accounting for income into the future, betting that lower tax rates will arrive, perhaps in 2018. Due to the expected tax cut, which may come soon, most high-net-worth individuals want to defer their income. The U.S. stock market has also rallied since Trump's election victory in November, partly on hopes for lower corporate tax rates.

The delay of tax payments could help explain why tax receipts this fiscal year are coming in more slowly than projected, said tax experts and the Congressional Budget Office (CBO). "Taxpayers may have shifted more income than projected...to later years, expecting legislation to reduce tax rates to be enacted this year," the CBO said in a recent monthly report.

The weaker tax revenues this year have forced the U.S. Treasury to borrow more money than expected to cover the federal budget deficit, and that is putting the government on track to hit its legal debt limit sooner than expected, experts said. The U.S. government has a legal limit on how much it can borrow, currently set at approximately $19.8 trillion, and the limit can only be increased by a vote of Congress. Since mid-March, the U.S. Treasury has been using emergency funding powers to postpone hitting the debt limit, and those measures had been expected to last until about October, but lower tax receipts so far this year may mean the debt limit will be hit sooner than expected. Treasury Secretary Steven Mnuchin urged Congress last month to raise the debt ceiling before lawmakers break for a long August summer recess, a call echoed last week by House Democratic leader Nancy Pelosi.

Opportunities for deferral? Those who are betting on lower rates might consider some of the following ways to defer income into 2018 or beyond:

- Defer a traditional IRA-to-Roth IRA conversion until 2018. Such a conversion generally is subject to tax as if it were distributed from the traditional IRA or qualified plan and not recontributed to another IRA.
- Defer property sales that would generate a large investment gain (assuming the sale price would likely stay more or less

the same); or, if the sale cannot be postponed, structure the deal as an installment sale. (Although the capital gain tax would stay in place under Trump's plan, the 3.8% net investment income tax would be eliminated.)

- An employee who typically receives a year-end bonus can request that his or her employer delay payment of the bonus until early 2018.
- Consider selling property at a loss in 2017 instead of 2018 (assuming your income will likely stay more or less the same).
- Accelerate deductions into 2017 (again, assuming your income will likely stay more or less the same).

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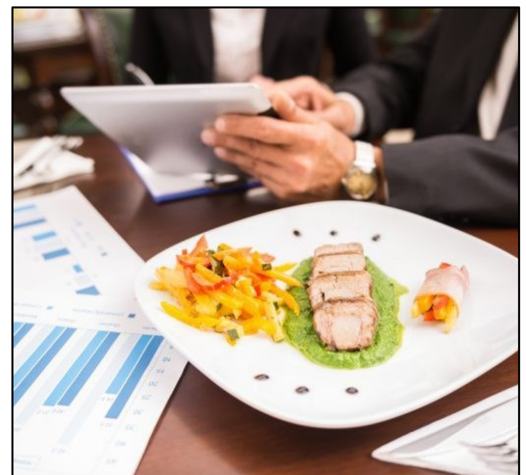
Maximize Tax Deductions on Business Meals and Entertainment

Many businesses consider the occasional wining and dining of customers and clients just to stay in touch with them to be a necessary cost of doing business. The same goes for taking business associates or even employees out to lunch once in a while after an especially tough assignment has been completed successfully. It is easy to think of these entertainment costs as deductible business expenses, but they may not be. As a general rule, meals and entertainment are deductible as a business expense only if specific conditions are met. Additionally, the deduction for either type of expense generally is limited to 50% of the cost.

Meals and entertainment directly connected to business. To be considered directly connected to business, the meal or entertainment event must meet three conditions:

- It must have been scheduled with more than a general expectation of deriving future income or a specific business benefit from the event. In other words, a meal or dinner date arranged for general goodwill purposes does not qualify.
- A business meeting, negotiation, or transaction must actually occur during the meal or entertainment, or immediately preceding and following it. In other words, business actually must be discussed.
- The main character of the event, considering the facts and circumstances, is the active conduct of your company's trade or business.



For example, an executive employee who treats a client to a golf game in order to discuss the general parameters of a business deal in an informal atmosphere is engaged in entertainment that is directly connected to business; so is a manager who discusses sensitive business plans with a subordinate over lunch at an off-premises restaurant.

Applicable limitations. In general, only 50% of expenses incurred for entertainment and meal expenses is deductible. A limited exception applies to entertainment or on-premise meals provided to employees. Expenses with respect to entertainment facilities generally are not deductible at all. A facility includes any item of personal or real property owned, rented, or used by a taxpayer if it is used during the tax year for, or in connection with, entertainment. They include yachts, hunting lodges, fishing camps, swimming pools, tennis courts, bowling alleys, automobiles, airplanes, apartments, hotel suites and homes in vacation resorts.

Country club dues are not deductible (although the meals purchased with business clients at the club are, up to the 50% limit). Deductions for skyboxes or other private luxury boxes at sporting events are limited to the face value of a nonluxury box seat ticket multiplied by the number of seats in the box.

Record-keeping requirements. Even if a meal or entertainment expense qualifies as a business expense, none of the cost is deductible unless strict and detailed substantiation and recordkeeping requirements are met to the letter.

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Safeguard Tax Benefits Against Natural Disasters

As "hurricane season" officially begins, the IRS has released a number a tax tips, reminders and other advice to help taxpayers weather the storm of natural disasters and similar emergencies. The underlying theme for all IRS "tax tips" is that recordkeeping has generally become easier in the digital age. However, it remains the primary responsibility of the taxpayer to preserve adequate records whether or not caused by a disaster.

Bottom line: Although the IRS will often extend filing deadlines and generally offer "hot line" accessibility, the "burden of proof" on substantiation and other requirements found within the tax laws is ultimately placed upon the taxpayer's shoulders.

Preparation Checklist

The IRS advises taxpayers to consider taking the following steps, among others, to better prepare for hurricanes and other emergencies:

Emergency plans

Personal and business situations change over time, as do preparedness needs. An emergency plan, both at home and in business, whether for safety or to prepare for insurance claims and tax contingencies, should be updated annually.

Digital copies of key documents

The IRS advises that taxpayers should keep a duplicate set of key documents including bank statements, tax returns, identifications and insurance policies in a safe place, away from the original set. The IRS observes that maintaining an additional set of records should be easier these days, with many financial institutions providing statements and documents electronically and on secure internet sites. Even if the original records are only provided on paper, the IRS suggests scanning them into an electronic format.

Taxpayers should also photograph or videotape the contents of their residences, especially items of higher value. The IRS disaster loss workbooks and Publication 584 can help taxpayers compile a room-by-room list of belongings. A photographic record can help taxpayers prove the fair market value of items for insurance and casualty loss claims. Ideally, photos should be stored outside the area of the home or office.

Payroll providers

The IRS suggests that employers who use payroll service providers should ask the provider if it has a fiduciary bond in place. It notes that the bond could protect the employer in the event of default by the payroll service provider.

IRS data storage

Back copies of previously filed tax returns and all attachments, including Forms W-2, can be requested by filing Form 4506, Request for Copy of Tax Return. Alternatively, transcripts showing most line items on these returns can be ordered through the Get Transcript tool available on the IRS website, or by calling 1-800-908-9946 or by using Form 4506T-EZ, Short Form Request for Individual Tax Return Transcript, or Form 4506-T, Request for Transcript of Tax Return.

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Understanding the Rules on Passive Losses

Individuals, trusts, estates, personal service corporations, and closely held C corporations may only deduct passive activity losses from passive activity income. The rules do not apply to S corporations and partnerships but do apply to their respective shareholders and partners. In general, limited partners are not deemed to materially participate in partnership activities. Thus, a limited partner's share of partnership income is passive income. However, general partners or acting general partners may hold limited partnership interests and materially participate in the partnership.

Closely held C corporations and personal service corporations are treated as materially participating in an activity if shareholders owning 50% or more by value of the outstanding stock materially participate in the activity. Closely held C corporations can also satisfy the material participation standard under an alternative rule based on the participation of full-time employees in the activity.

A passive activity is trade or business activity in which the taxpayer does not materially participate. Passive activities generally include rental activities, regardless of whether the taxpayer materially participates in the activity. However, a taxpayer's rental real estate activity is not a passive activity if the taxpayer materially participates in the activity and performs qualifying services in the real estate industry. A facts and circumstances test should be applied in determining whether the taxpayer's other activities are combined or treated as separate for purposes of the passive loss rules.

Individuals who own and actively participate in the management of rental real estate may offset up to $25,000 of passive activity loss from rental real estate against active income in any tax year. The offset amount is reduced by 50% of the amount by which the taxpayer's adjusted gross income exceeds $100,000, phasing out completely at $150,000 of adjusted gross income. More liberal rules apply to the offset of rehabilitation and low-income housing credits.

Deductions and credits that are disallowed under passive activity rules may be carried forward and used as passive activity deductions and credits in succeeding years. Remaining passive activity deductions are deductible against nonpassive income when a taxpayer disposes of the passive activity. Passive activity credits may only be applied to taxes on passive income.

A major exception to the definition of a passive activity is a working interest in any oil and gas property that the taxpayer holds directly or through an entity that does not limit the taxpayer's liability for the interest, regardless of whether the taxpayer materially participates in the activity. A taxpayer's passive activity loss for the tax year is disallowed and is carried forward until the taxpayer has available passive activity income. Passive activity loss is the amount by which passive activity deductions from all passive activities exceed passive activity gross income from all passive activities for the tax year.

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Sale of Furnished House: Mixing Real and Personal Property

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Taxpayers were liable for additional tax after the California Franchise Tax Board (FTB) adjusted the reported basis in the home they sold in 2007. The taxpayers increased their basis in the home by factoring in the furnishings but did not then report the part of the sale allocated to the furnishings.

The taxpayers sold their house and its contents for $7,150,000. One of the sale's documents set aside $400,000 from the purchase price and specified that sales commissions were not to be paid on that amount. The $400,000 was listed as "paid for furniture." However, when calculating their gain on the sale of the residence, the taxpayers used a selling price of $6,750,000 and had factored in the basis of their personal property, which deflated the gain reported. The taxpayers' many arguments all fell flat: They argued the FTB undervalued the personal property and, as support, presented several home sales in their area. However, these were sales of homes that did not include furnishings. They also argued that because of the quick turnaround on the sale, they did not have time to create an inventory or attribute value to the items. The FTB's argument was that the taxpayers had isolated the real property when reporting gain realized, but combined the basis of the real property and personal property when reporting their basis. The FTB looked at the way the sale was reported and noted that the taxpayers had reported a sale price of $6,750,000 listed on their Schedule D and on their 1099-S, neither of which is used to report sales of personal property, only real property. The FTB concluded that its recomputation of basis excluding the personal property basis was correct.

The backstory is the real story

After reading a case document, most of the time the very next thing to do is an online search of the taxpayer. This is where we find out things like the taxpayer is a famous actor using his given name on the case document (Giovanni Ribisi) or that the perpetrator of a stolen tax refund is a second-level LinkedIn connection (Stephen McDow).

Once again, the internet did not disappoint. When we searched the taxpayers' names, the second hit was a story about their purchase of the Los Tiempos mansion, formerly owned by iconic Los Angeles Times publisher Norman Chandler. To buy Los Tiempos, the taxpayers had sold their more modest mansion in the 2007 whirlwind deal that included their furnishings, at the height of the housing bubble. The buyers? Britney Spears and Kevin Federline.

In making their arguments to the Board regarding the valuation of their 2007 sale, the taxpayers questioned the FTB's motive in going after them, saying they were unable to pay the extra tax and alluding to a fraud scheme that wiped out their finances. That fraud scheme was the purchase of Los Tiempos. It allegedly had been restored by the previous owner, an interior designer, but upon moving in, the taxpayers discovered black mold, faulty electrical wiring, and sewage leaks under the house. They sued the sellers, their brokers, and the contractors who had done work on the house.

They then spent almost $3 million on repairs, necessitating selling off family heirlooms and raiding their son's trust fund. At one point, the taxpayers hooked up with the reality show "Flipping Out" to do some of the repair work, and in true reality TV style, that relationship ended spectacularly when the taxpayer-wife got into a screaming match with the show host. You know what they say: May you live in interesting tiempos.

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States' Tax Amnesty Program - Oklahoma and Virginia

The Oklahoma Tax Commission (Commission) has been authorized under the new law to establish a "Voluntary Disclosure Initiative" for eligible taxes (including the state corporate income and sales and use taxes) that permits a waiver of penalty, interest, and other collection fees due on eligible taxes if a qualifying taxpayer voluntarily files the delinquent tax returns and pays, or agrees to pay, taxes due during the period beginning September 1, 2017, and ending November 30, 2017, pursuant to a written payment program with the Commission. To be eligible to participate in this Voluntary Disclosure Initiative, taxpayers must:

- not have outstanding tax liabilities other than those reported pursuant to this Voluntary Disclosure Initiative;
- not have been contacted by the Commission or third party acting on behalf of the Commission, with respect to the taxpayer's potential or actual obligation to file a return or make a payment to Oklahoma;
- not have collected taxes from others, such as sales and use taxes or payroll taxes, and not reported those taxes; and
- not have entered into a voluntary disclosure agreement for the type of tax owed within the preceding three years.

Pursuant to recently enacted legislation, the Virginia Department of Taxation (Department) has issued some initial guidance on its administration of the 2018 fiscal year tax amnesty program which will occur at some point during July 1, 2017 through June 30, 2018, for a period ranging between 60 and 75 days. The forthcoming amnesty program will provide a potential 50% interest waiver and 100% penalty waiver. It will generally be open to any taxpayer that is required but has failed to file a return or pay any tax administered by the Department.

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