TAX REFORM OUTLINE ANNOUNCED ON APRIL 26

The Trump Administration has released its outline for the corporate and individual tax reforms. Here is the summary of key points included in the outline.

- ***15% Corporate Tax Rate - also applied to "pass-through" income.*** The corporate income tax rate would be lowered from 35% to 15%. The reduced tax rate would also apply to "pass-through income" (income from S-corporations and partnerships).

- ***"Territorial" International Tax System.*** The US government would no longer tax income on a world-wide basis; instead, the US tax system will be shifted to a "territorial" system. However, there would be a one-time tax on all "offshore" income that has not been repatriated.

- ***Lower Individual Income Tax Rate.*** The current seven individual income tax brackets are consolidated into three brackets - 35%, 25% and 10%. The top bracket is reduced from the current 39.6% to 35%.

- ***Changes to Individual Itemized Deductions.*** The two most significant proposals would be a doubling of the standard deduction and the revocation of state and local tax deduction. All individual deductions except for the deduction for mortgage interest and charitable contributions would be eliminated.

- ***Estate Tax, Alternative Minimum Tax, and "ObamaCare Surcharge" Repeal.*** The plan eliminates the estate tax, the alternative minimum tax (AMT), and the 3.8% additional net investment tax added under the Affordable Care Act.

The tax reform for businesses and individuals is being driven by two proposals: one made by President Trump during the campaign last year and the other by the House GOP (known as the GOP blueprint). In many areas, the two find common ground, including a cut in the corporate tax rate consolidation and a reduction in the income tax rates for individuals, elimination of the federal estate tax, and abolishment of the alternative minimum tax (AMT). President Trump has also called for new tax incentives for child and elder care.

For more information about this article, please contact our tax professionals at taxalerts@windes.com or toll free at **844.4WINDES** (844.494.6337).

IRS Issues 2017 Inflation-Adjusted Vehicle Depreciation Dollar Limits

The IRS has released the inflation-adjusted limitations on depreciation deductions for business-use passenger automobiles, light trucks, and vans first placed in service during calendar year 2017. All limitations are inflation-adjusted based upon October 2016 consumer price index amounts, with rounding conventions that account for almost all 2016 limits remaining the same for 2017 (only the third-year limitation for light trucks and vans rose, from $3,350 to $3,450 in 2017).

The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) has allowed for 50 percent bonus depreciation, where applicable, through 2017. For both passenger automobiles and light trucks and vans, that amount raises first-year depreciation by $8,000. The bonus rate is scheduled to drop to 40 percent for property placed in service in 2018 and to 30 percent for 2019, before sunsetting entirely unless changed by Congress.

Automobiles/light trucks/vans

For passenger automobiles that are not trucks and vans first placed in service in 2017, the depreciation limitations under Internal Revenue Code (IRC) Section 280F for the first three years are $3,160 ($11,160 with additional first-year depreciation), $5,100, and $3,050, respectively, and $1,875 for each succeeding year.

For trucks and vans, the 2017 maximum deduction limits under IRC Section 280F for the first three tax years are $3,560 ($11,560, with additional first-year depreciation), $5,700, and $3,450, respectively for years two and three, and $2,075 for each succeeding year. Lease inclusion tables for vehicles first leased in 2017 are provided with the applicable inclusion amounts.

Leases

IRC Section 280F provides that lease payments for vehicles used for business or investment purposes are deductible in proportion to the vehicle's business use. Lessees must include a certain amount in income during the year the vehicle is leased to partially offset the amounts that the lease payments exceed the luxury automobile limits. Revenue Procedure 2017-29 includes tables identifying the income inclusion amounts for passenger automobiles starting at $19,000, and for trucks and vans starting at $19,500 (with both tables topping out at a $240,000 value), in connection with lease terms beginning in calendar year 2017.

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What Portion of the Property Tax Bill is Tax Deductible?

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California conforms to federal law regarding the real estate tax deduction, which is an allowable itemized deduction for both federal and state income tax. California differs from most other states, however, in that many California property tax bills include large special assessments that are not allowable as deductions. In general, the allowable deduction amount is the *ad valorem* tax, or the amount based on the assessed value of the property. Special assessments included in the property tax bill, such as for Mello-Roos or for various services provided to specific properties, are generally not deductible. This is an important issue because some taxpayers have very large Mello-Roos assessments on their property tax bills.

What is deductible?

Deductible real property taxes are those levied for the general public welfare by the proper taxing authority at the same rate against all property in the territory over which the authority has jurisdiction. Taxes assessed against local benefit of a kind tending to increase the value of the property, such as levies paid for paving, sewers, streets, sidewalks, drainage, and other similar property improvements, are capital investments and are not deductible as taxes.

Taxes allocated to ordinary maintenance and interest charges are deductible, but the regulations provide that the burden is on the taxpayer to show the allocation. Expenses for the operation, planning, organization and administration, costs of engineering and legal services, the office equipment, or the cost of billing are not deductible as maintenance expenses. Deductible maintenance expenses do include, in the case of a water system, for instance, expenses incurred for the repair and maintenance of a purification system, pumping system or distribution system.

Special assessments

Unlike property taxes that are levied for general revenue purposes and apply to all property over which a taxing agency has jurisdiction, benefit assessments (sometimes called "special assessments") are levied for specific improvements and apply only to property that derives a benefit from the improvements.

Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. However, a decision to the contrary was reached in a General Counsel Memorandum (GCM) dated November 24, 2003, which concluded that deductions for real property taxes are not limited to *ad valorem* taxes. The GCM concludes that, even though not based on the value of the property, these "special taxes" are still determined by a "like-rate" against all property in the jurisdiction. This means that they may be deductible. The GCM concludes that an analysis of the facts and circumstances of these special taxes may be necessary.

Under this analysis, some Mello-Roos assessments might be deductible. The problem is that the taxpayer is probably not going to be able to determine what the Mello-Roos assessment is being used for. So, although a portion of the Mello-Roos may be tax deductible, finding out how much that is will be a challenge to the most determined taxpayer.

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Lack of Contemporaneous Written Acknowledgement Nixes Donation

In a case that provides a lesson to anyone donating property to charity for which a deduction of more than $500 is claimed – get proof in writing and get it at the time you donate the property. After-the-fact substantiation, no matter how convincing, is not acceptable under the tax law to support a deduction.

Case in point: The Tax Court, in *Izen, Jr. v. Commissioner*, 148 TC No. 5, found that a failure to follow the substantiation rules for donation of an aircraft precluded a taxpayer from claiming a deduction. The taxpayer's evidence of donation did not satisfy the substantiation requirements, which are heightened for donations of vehicles, including aircrafts.

The taxpayer was assessed a deficiency on his federal income tax return for the year at issue. He then filed an amended return on which he claimed that he had donated a 50 percent interest in an aircraft to a tax-exempt historical society. His interest in the plane was appraised at $340,000, and he claimed a charitable contribution deduction in that amount.

The Tax Court observed that under IRC Section 170(f)(12), contributions of used vehicles, including airplanes, whose claimed value exceeds $500, must satisfy special substantiation requirements. A taxpayer must obtain a contemporaneous written acknowledgment and include the acknowledgment with his or her return. Further, if the donee has not sold the vehicle or aircraft, the donee must certify the intended use or improvement to the property, among other requirements. Additionally, the donee must provide the IRS with a copy of the acknowledgment. The IRS developed Form 1098-C for this purpose. The court found that the taxpayer did not include the requisite copy of Form 1098-C with his amended return, nor did the IRS receive the form from the historical society related to the taxpayer's donation of the aircraft.

Although the taxpayer did include a copy of a letter to the IRS that was from the historical society thanking him for the donation, the court found that the letter failed to satisfy the contemporaneous written acknowledgement requirements. The letter failed to include the name and taxpayer identification number of the donor, among other items.

The court also rejected the taxpayer's purported deed of a gift as satisfying the contemporaneous written acknowledgment requirement. The "aircraft donation agreement" did not meet the statutory requirements for a contemporaneous written acknowledgment.

Like the letter, the deed failed to include the taxpayer identification number of the donor. The deed also did not include a certification of intended use.

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Maximize Start-Up Deductions for a New Business

Starting a new business venture can prove exciting, but rather costly. There are certain tax advantages that can help alleviate some of the financial burden associated with entrepreneurship.

A taxpayer may start a business by forming an entirely new business or acquiring an existing business. One of the most important decisions a business owner should make is to choose a type of business entity. If the business is entirely new, the taxpayer will be able to choose the type of entity from inception; however, if the taxpayer purchases an entity that differs from the entity of choice, the taxpayer must convert the purchased entity to the entity of choice. Be aware that each type of entity—be it sole proprietorship, corporation, or partnership—comes with its own advantages and disadvantages.

Regardless of the type of business entity that a taxpayer decides on for his or her new business, a portion of the start-up costs may be deducted, with amortization available for the remainder. Start-up costs are those incurred in investigating or creating an active trade or business before the day on which the active trade or business begins. Further, expenses paid or incurred before a business commences operations are start-up costs. Such costs do not include interest, taxes or research, nor do they include experimental expenditures. In addition, the cost must be one that would have been deductible if incurred in connection with an existing business in the same field.

Eligible start-up costs fall within three categories: investigatory, business start-up, and pre-opening costs. Start-up expenses include:

- advertising costs;
- training costs;
- travel expenses incurred in lining up distributors, suppliers, or customers; and
- fees incurred for executives, consultants, and similar professional services.

Start-up expenses do not include:

- acquisition costs;
- amounts paid for the purchase of property;
- organizational costs; or
- deductible ordinary and necessary business expenses paid or incurred in connection with an expansion of a business.

A taxpayer beginning a new business can take a first-year deduction on the first $5,000 of start-up costs. Note that for tax years beginning in 2010, the deduction is $10,000. The $5,000 deduction is reduced dollar-for-dollar to the extent start-up expenses exceed $50,000. Any excess amount must be amortized over a 180-month period. For start-up expenses incurred in 2010, the deduction is limited to $10,000, and are reduced to the extent that expenses exceed $60,000.

Partnerships and corporations are deemed to have made an election to deduct start-up expenditures for the tax year in which the business begins an active trade or business. Such business entities may choose to forgo the deemed election by affirmatively electing to capitalize its start-up expenditures on a timely filed federal income tax return for the tax year in which an active trade or business begins.

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California Filers Subject to $10,000 Penalty for Failure to File Form 8938

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In 2015, California enacted legislation that conformed to the federal foreign account disclosure (FATCA) requirements. This means that individuals and businesses that have specified foreign financial assets must file Form 8938, Statement of Specified Foreign Financial Assets, with the California return. The confusion arises when:

- the taxpayer is a California nonresident;
- the taxpayer is a nonresident alien; and
- whether attaching the federal return will meet the requirement.

California nonresident

Any individual or any business entity required to file a Form 8938 with the IRS who files a California return must comply with the FATCA requirement. So, if a nonresident has a filing requirement and meets the FATCA reporting criteria of Internal Revenue Code (IRC) Section 6038D and California Revenue & Taxation Code (R&TC) Section 19141.5, the taxpayer must attach a Form 8938 to the California nonresident return.

Nonresident alien

For federal purposes, some nonresident aliens are not required to report foreign assets. However, California law does not conform to the federal nonresident alien provision, including the FATCA filing requirements, so a nonresident alien with California-source income must complete and file Form 8938 with the California return.

Meeting the filing requirement

For individuals, in most cases, the FTB requires a copy of the federal tax return to be attached to the California return. The requirement will be met if the Form 8938 is attached to the federal return. If not, you must complete and attach a copy of Form 8938. For business returns, attach a copy of the Form 8938 if the entire federal return was not attached. The Form 8938 may be included as part of an e-filed return. If a paper return is filed, the Form 8938 must be attached to the return.

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