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Tax Tips for Website

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**Business or hobby?**

This continues to be an important issue area for the IRS. IRS Code Section 183 (Activities Engaged in for Profit) limits deductions that can be claimed when an activity is not engaged in for profit. IRC 183 is sometimes referred to as the "hobby loss rule."

Is your activity really an activity engaged in for profit? In general, taxpayers may deduct ordinary and necessary expenses for conducting a trade or business or for the production of income. If you are not sure whether you are running a business or simply enjoying a hobby, here are some of the factors you should consider:

- Do you run the activity in a businesslike manner?
- Does the time and effort put forth into the activity indicate an intention to make a profit?
- Do you depend on income from the activity?
- If there are losses, are they due to circumstances beyond your control or did they occur in the start-up of the business?
- Have you changed methods of operation to improve profitability?
- Do you or your advisors have the knowledge needed to carry on the activity as a successful business?
- Have you made a profit in similar activities in the past?
- Does the activity make a profit in some years? (See below for safe harbor)
- Do you expect to make a profit in the future from the appreciation of the assets used in the activity?

Safe Harbor: An activity is presumed to be "for profit" if it makes a profit at least three out of the last five years including the current year (or at least two of the last seven years for horse related activities). Even if the safe harbor not met, facts and circumstances may dictate an activity as trade or business.

**Planning Points>**

- **When entering into an activity and ongoing in the life of that activity, keep the above in mind.**
- **Consult a tax advisor before entering a venture to discuss the above.**

## College Education credits and deduction

The American Opportunity Tax Credit creates an up to $2,500 higher education tax credit (direct reduction in tax) that is available for the first four years of college and is based on amounts paid for tuition, fees and books and supplies (like computers) for a student enrolled at least one-half time at a qualified educational institution. This credit can be up to 40% refundable. The credit has an adjusted gross income limit subjecting it to phase out of $160,000 on a joint return or $90,000 on a single return. This credit was made permanent with the 2015 tax Act.

The Lifetime Learning credit remains unchanged at a maximum $2,000 and is available for any college year, not limited to just the first four. Unlike with the American Opportunity credit, nothing but tuition is included in determining eligible expenses.

There was, through 2016, an above the line deduction for college tuition expenses paid limited to a maximum $4,000 deduction phased out starting with AGI of $80,000 ($160,000 joint filing), if you don't qualify for the tax credits above***. It is unknown now if this will get extended past 2016***.

**Planning points>**

**This can be a good way to fund higher education and get some sort of tax break for doing it. The sooner you make contributions the sooner your money starts growing, possibly tax free.**

## College Education Savings Plan

Contribute to a section 529 tuition plan for higher education. Investments grow tax free, and if you invest in the NEST plan for Nebraska, you could get up to a $10,000 deduction for Nebraska income taxes. Distributions are tax free 100% if used for qualified educational expenses including, tuition, books, fees, room & board (if a ½ time student).

**Planning points>**
**The plan must be funded each year by December 31st each year to receive the state only tax deduction. It is recommended any distributions are taken in the same year as the qualifying expenses are paid. Since the annual contributions count towards the gifting annual exclusion amounts, beware of the rules regarding the gift tax return filing options and requirements if you contribute more than the annual gift exclusion amount to a 529 plan in any one year.**

**Even if you have to take a distribution and not use it for qualified education expenses, you will only be taxed on any earnings on the distribution, not the amount contributed that is considered part of the distribution**

## 3.8 percent net investment tax

If a threshold of $200,000 modified adjusted gross income ($250,000 for a joint return) is exceeded, then certain "investment" income is subject to a surtax of 3.8% under the Affordable Care Act. Even though long capital gains income will still receive favorable tax rates, the benefit from such could be diminished buy this surtax. Net investment income includes dividends, interest, rents, capital gains, royalties, annuities and activities where you are a passive participant. Self-employment income, income from an active trade or business and portions of gain on sale of business interests as well as IRA or qualified retirement plan distributions, are not subject to the surtax. ***It is unknown now when or how this will be changed or repealed with possible health care reform legislation.***

**Planning points>**
**It is important to work with your tax advisor to lessen the blow of this surtax through deferral of income recognition, acceleration of deductions, the nature of the income received, or your participation levels in activities. There is no one or two advice rules that can apply to everyone. It really is on an individual basis to review the options.**

## Moving Expenses

A tax break may be coming your way if you moved to another city for a new job or because your old job is now at a new location. How far you moved and the amount of time you spend on the job will have an impact on whether you qualify for the tax break.

If you satisfy the distance and time tests then job related moving expenses you incur out of pocket costs for may be tax deductible. You will meet the distance test if your new work place is at least 50 miles further form your former home than your previous workplace was form that home. The time test requires you to work full-time for at least 39 weeks during the 12 months immediately after your move. There are special rules for self-employed people and members of the armed forces.

Reasonable moving costs are deductible and include the costs of moving your household goods and personal effects to your new home. You can also deduct the expenses of traveling to your new home, including lodging (but not meals) costs.

**Planning points>**
**Keep these things in mind if you move and keep good records of your moving costs to substantiate the possible deduction on your tax return.**

**Employee vs. Independent contractor**

One of the areas that continue to be aggressively pursued by the IRS is the reclassification of workers as employees rather than independent contractors. There is no full proof determination to be able to classify a worker as an employee or independent contractor but the courts have looked to these areas to determine the proper classification:

- Behavioral Control
  How much control over the worker is there about instructions to do the work? The more instructions dictated to the worker, the greater indication they are an employee.

  How much training do you need to give the worker? The more training the more likely an employee.

- Financial Control
  If you have significant investment in your work you may be an independent contractor.

  If you incur expenses for the job not reimbursed, you may be an independent contractor.

  If you can realize a profit form the work or a loss, this suggests you may be in business for yourself and an independent contractor.

- Relationship of the parties
  Do you get benefits like other employees? This suggests employee relationship.

  Are there any contracts showing the intent of the work relationship? This will lean one way or the other towards employee relationship.

**Planning Point>**
**Look at relationships with workers, whether you are the employer or the hired worker, based on the above items to help determine the proper worker classification. Discussion with your tax advisor prior to entering a worker relationship if in doubt would be advisable. Penalties for misclassification can be steep.**

## Employers complying with the Affordable Care Act (ACA)

Rules went into effect starting 2015 affecting health insurance coverage required to be offered to employees and year end reporting to employees by employers, especially those with over 100 full time equivalent employees, but also reporting requirements for those employers with as few as 50 full time equivalent employees. ***It is unknown now when or how this will be changed or repealed with possible health care reform legislation.***

**Planning points>**
**The rules are complicated but penalties for non-compliance can be severe. Please read up on the extensive information through the IRS website and/or contact your tax advisor to become education on requirements that may affect you as a large or small business employer.**

## Depreciation options

The expensing election of certain property purchases, such as equipment, (known as Sec 179 expensing) was extended permanently with the tax Act of 2015. Starting in 2015 the amount that can be expensed annually is up to $500,000 of qualifying expenditures (with phase-out starting at $2,000,000 of purchases). These amounts will be indexed for inflation in future years. There are some income limits that also affect how much can be deducted annually.

Bonus depreciation was extended too by the tax Act of 2015. For 2015-2017, 50% of **new** equipment only can be expensed. There are no income limits like the Sec 179 expensing but is does not apply to used equipment. The percentage write-off is schedule to decrease in 2018 and 2019 and expire thereafter.

Under the luxury vehicle rules, limits are placed on otherwise allowable deductions for autos, light trucks and minivans. The law keeps the increased first year limits by $8,000 on luxury vehicles purchased in 2017.

This year, businesses have an opportunity to expense otherwise capitalized tangible property costs of the de minims rule is met. Known as the repair regs. If certain elections made and financial reports prepared, then a set amount of otherwise capital items can be expensed outside of those under section 179 discussed above. If a business prepares applicable financial statements (AFS) they can use the de minimis election to expense up to $5,000 items individually and if no AFS then the limit is $2,500.

**Planning point>**
**The Sec 179 and bonus depreciation provisions give wide decision making opportunities to businesses looking to expense currently large equipment purchases. There is a large list of items that qualify for these or don't, besides equipment, so consult your tax advisor if you are considering certain property purchases.**

## Recordkeeping

Recordkeeping is a critical business practice that enables a business to have accurate information related to income and expenses. A business is required to keep receipts, sales slips, invoices, ban deposit records, cancelled checks and other documents to substantiate items of income, deductions, and credits.

Why should you keep records? There are many reasons why someone should keep good records. Several important reasons are below:

- Monitor business success
- Identify Sources of Income
- Identify deductible expenses
- Support entries on a tax return in the event the return is audited
- It is required by law

The law does not require the business to maintain their records in any particular way. The business can select the recordkeeping system and accounting methods that are suitable for their business needs. Organization is the key whether paper or electronic records are kept.

The client must keep their records as long as they may be needed for the administration of the Internal Revenue Code. Generally, this means they must keep records that support an item of income or deduction on a return until the period of limitations for that return expires. There may be some records that should be kept permanently and for other regulatory purposes other than taxes. The list is too long to present here of what should be kept how long.

**Planning point >**
**Good records cannot be over emphasized. We can provide a list of different records and suggest retention times, if needed. IRS Publication 583, starting a Business and Keeping good Records found on the IRS website at IRS.gov can be helpful, also.**

**Limited Liability...Well…Maybe not so much**

The most cited hallmark of LLC's is the limited liability protection afforded to the member owners and managers of the company. The issue not discussed very often is that the exceptions to the limited liability protection rule. There are exceptions as follows:

- Personal guarantee of LLC debt.
- Torts committed by a manager or member.
- Piercing through the LLC veil to the members (like piercing the corporate veil) by legal action.
- Wrongful distribution liability.
- A stated written capital contribution obligation (whether cash, property or the promise to perform services.)

It is beyond these planning points to go into depth on any one of these. It is very important to highlight these issues at the initial LLC organizational meeting.

**Planning point>**
**If contemplating an LLC as a form of business these items need to be considered and discussed with the attorney involved in the LLC formation to get a further understanding of potential actual liability in the LLC form of business**.