Lally&Co.
CPAs and Business Advisors

The
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This Issue:

- **White House Calls for Big Individual and Business Tax Cuts, and More**
- **Lack of Contemporaneous Written Acknowledgement Nixes Donation**
- **How Do I Maximize Start-up Deductions for a New Business?**
- **What are Miscellaneous Itemized Deductions?**

The Evergreen. Always Growing.

Like the evergreen oak tree, Lally & Co. is always growing. With the support and loyalty of our clients and friends we have grown into a firm of 42 individuals serving clients in many diverse fields. Our growth gives us the ability to better serve our clients and provide effective solutions to their needs. If you have questions about your business or personal tax situation, please contact us. We welcome your call and are always looking for ways to better serve you.

Contact our office or visit our new website for more information.

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Dear Clients and Friends,

Spring has arrived and with that came the end of another "busy" season. We would like to extend our sincere gratitude for the trust you have invested in us. Our clients and referral sources are the reason we had one of our busiest and most successful tax seasons. It would not have happened without each of you.

As you read through *The Evergreen*, please do not hesitate to contact us if you have questions regarding an article or regarding your business or personal tax situation. We would be happy to hear from you! This and past issues of *The Evergreen* are available on our website at http://lallycpas.com/newsletters/.

White House Calls for Big Individual and Business Tax Cuts, and More

President Trump has unveiled a tax reform outline -the "2017 Tax Reform for Economic Growth and American Jobs." The outline calls for dramatic tax cuts and simplification: lower individual tax rates under a three-bracket structure, doubling the standard deduction, and more than halving the corporate tax rate; along with changing the tax treatment of pass-throughs, expanding child and dependent incentives, and more. Both the alternative minimum tax and the federal estate tax would be eliminated. The White House proposal does not include spending and tax incentives for infrastructure; nor a controversial "border tax."

According to White House officials, the President's proposals set out broad principles with specifics to be hammered-out in coming weeks. This Briefing presents a high-level overview of the President's proposals.

At this time, the White House proposals are just that, proposals. No legislative language has been revealed. Congressional tax writing committees will need to weigh in. The House Ways and Means Committee and the Senate Finance Committee have been engaged in tax reform discussions both in public and behind the scenes. Regarding a timeline, Administration officials have predicted that tax reform "will not slide into 2018."

(Continued on Page 2)

Firm Announcements

Christine Fromlak successfully completed and earned a Master's in Accountancy degree from LaRoche College in July 2016

Bobby Septak successfully completed and earned a Master's in Business Administration degree from the University of Pittsburgh in May 2017

Thomas Lutz married Kristen Boland in May 2017

Important Dates

June 15, 2017 – 2016 2nd Quarter Estimated Payments Due

Individuals

Tax Rates

The President's proposal calls for replacing and lowering the current individual tax rates with a new, three-bracket range: 10, 25, and 35 percent. Under current law, individual income tax rates are 10, 15, 25, 28, 33, 35, and 39.6 percent. White House officials said that the Administration has not yet developed the income brackets for the new rates. The House GOP Tax Reform Blueprint has called for a rate structure of 12, 25, and 33 percent.

Standard Deduction

The President's plan calls for doubling the standard deduction. The 2017 standard deduction amounts under current law are $6,350 and $12,700, respectively, as adjusted for inflation. One goal of a higher standard deduction is to simplify tax filing by cutting more than half of those taxpayers who would otherwise do better itemizing deductions.

During his campaign, Trump had also proposed a cap on the amount of itemized deductions that could be claimed at $100,000 for single filers and $200,000 for married couples filing jointly. Additionally, according to campaign materials, all personal exemptions would be eliminated, as would the head-of-household filing status. These "give-backs" to offset some of the costs of the rate cuts and the higher standard deduction may arise during negotiations on Capitol Hill in ironing out the "details."

Deductions

The President's plan would eliminate all individual tax deductions except for the mortgage interest deduction and the charitable contribution deduction.

The loss of many itemized deductions would channel an even greater number of taxpayers to the standard deduction. Big losers may include state and local governments that depend upon the federal itemized deductions for state and local income taxes and real estate taxes as an indirect subsidy for those taxes. Losing the medical expense deduction and the miscellaneous itemized deduction will also prove difficult for some taxpayers. Above-the-line deductions apparently would also be eliminated, although the administration would carve out deductions for retirement savings.

The three largest refundable individual credits currently are the earned income tax credit, the additional child tax credit

(Continued on Page 3)

and the American Opportunity Tax Credit. In tax year 2015, these refundable credits totaled $102 billion, according to the Treasury Inspector General for Tax Administration. They may also be targeted for elimination.

Elimination of Targeted Tax Breaks

The President's tax proposal also outlines without elaboration the elimination of "targeted tax breaks that mainly benefit the wealthiest taxpayers." During his campaign, Trump had mentioned elimination of carried interest. Various "preference items" that are now caught in the AMT may also be targeted for change.

Net Investment Income Tax

The net investment income (NII) tax imposes a 3.8-percent tax on certain investment income of higher income taxpayers. The President has proposed to repeal the NII tax.

The President's proposal apparently keeps the current framework for capital gains and dividend taxes at the top 20-percent rate. The NII generally impacts individuals with adjusted income of above $200,000 ($250,000 for marrieds filing jointly.

The White House plan apparently does not include repeal of other Affordable Care Act (ACA) taxes, such as the additional Medicare tax and the excise tax on high-dollar health plans. At the time this Briefing was posted, negotiations were continuing in the House over the GOP's ACA repeal and replacement bill, the American Health Care Act (AHCA).

Family Incentives

The President's proposal calls for unspecified tax relief for families with child and dependent care expenses. Under current law, taxpayers who incur expenses to care for a qualified child or for an incapacitated dependent or spouse to work or look for work may claim a credit of 20 percent to 35 percent of employment-related expenses, depending upon income level and other factors.

Trump's campaign proposals included the creation of a new deduction for child and dependent care expenses, as well as increasing the earned income tax credit (EITC) for working parents who would otherwise not qualify for the deduction. A system of “spending rebates" and "above-the-line" deductions was proposed, as well as Dependent CARE Savings Accounts (DCSAs) with matching government contributions and an expanded credit for employer-provided child care.

Estate Tax

The President's proposal calls for elimination of the federal estate tax. The current maximum federal estate tax rate is 40 percent with an inflation-adjusted $5 million exclusion ($5.49 million in 2017).

During his campaign, Trump also mentioned replacing the estate tax with a carryover basis rule under which beneficiaries must use the decedent’s basis in inherited assets rather than their date-of death values. His proposal also does not answer the question of what will become of the gift tax.

Alternative Minimum Tax

The President's proposal calls for abolishing the AMT, calling it a complicated, unnecessary addition to the tax system. A parallel tax structure, the AMT, has existed for the stated purpose of ensuring that individuals, corporations, estates, and trusts with substantial income do not avoid tax liability. Despite exemptions, it has captured an increasing number of taxpayers to the extent that it forces many individuals "to do their taxes twice to see which is higher," according to the administration.

(Continued on Page 4)

Businesses

Corporate Taxes

The President's proposal calls for a 15-percent corporate tax rate. The maximum corporate tax rate currently tops out at 35 percent.

This proposal is being called one of the most aggressive within the President's plan, projected by some accounts to reduce revenues by $2 trillion over 10 years. Other projections call for economic growth to make up a significant part of the difference.

Although the current maximum corporate tax rate is 35 percent, many corporations now pay an effective tax rate that is considerably less. The President also proposed to eliminate unspecified tax breaks for "special interests," which would broaden the tax base and largely prevent most businesses from gaining an effective rate much lower than 15 percent.

Small Businesses

Currently, owners of S corporations and partnerships and sole proprietors pay tax at the individual rates, with the highest rate at 39.6 percent. The President has proposed a 15-percent tax rate for pass-through income.

Small business owners, therefore, would see their top tax rate reduced from 39.6 percent to 15 percent under the President's plan.

This plan would appear to give a business quasi-corporate status in being able to be taxed at a new 15 percent corporate tax rate, at least until assets are distributed. Upon distribution, Trump's campaign materials had indicated that a second layer of tax would be imposed similar to dividends now taxed to C corporation shareholders.

Trump's campaign materials also had indicated consideration of rules that would prevent pass-through owners from converting their compensation income taxed at higher rates into profits taxed at the 15-percent level. Mnuchin has stated that provisions would preclude wealthy owners of large companies from gaming availability of the lower rate.

Bonus Depreciation/Small Business Expensing

The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) extended and modified bonus depreciation and made permanent enhanced Code Sec. 179 expensing. The President's proposal does not specifically address bonus depreciation or small business expensing.

Business Credits

A number of business incentives were made permanent by the PATH Act, including the research credit, 100-percent gain exclusion on qualified small business stock, and the reduced recognition period for S corporation built-in gains tax. The President's proposal does not specifically address these and other business incentives.

Energy

Current law provides for many energy tax incentives for businesses (and individuals). The President's proposal does not specifically address energy tax incentives.

Some popular energy tax breaks have either expired or will soon expire, setting the stage for renewed negotiations in Congress; whether to extend them, make them permanent, or allow them to sunset permanently.

International

Repatriation

The President's plan calls for a one-time tax on repatriated profits at a yet-unspecified tax rate. The blueprint states that "trillions of dollars" are being held overseas and potential targets for repatriation.

In 2004, Congress provided that U.S. companies could elect, for one tax year, an 85-percent

(Continued on Page 5)

dividends received deduction for eligible dividends from their foreign subsidies.

The lower corporate tax rate of 15 percent may also provide incentive for businesses not to shift operations overseas going forward.

Territorial Tax Regime

The President's plan would also move to a territorial tax regime instead of a worldwide tax regime. "A territorial system means U.S. companies will pay tax on income related to the U.S.," Mnuchin said. "U.S. companies will not be subject to worldwide income," he added.

Infrastructure

In January, President Trump called for a $1 trillion infrastructure spending bill with unspecified tax incentives. The President's tax reform proposal does not address infrastructure spending.

"The President remains committed to a $1 trillion infrastructure spending initiative," Mnuchin said recently. Mnuchin had appeared to indicate that significant infrastructure tax incentives could be part of a final tax reform package.

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 Code Sec. 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

(Continued on Page 6)

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.

How Do I 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 a business expansion.

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.

(Continued on Page 7)

What are Miscellaneous Itemized Deductions?

Miscellaneous itemized deductions are certain nonbusiness expenses that individuals as taxpayers who otherwise itemize deductions may take against their taxable income. Such miscellaneous expenses are allowed only to the extent that they exceed 2-percent of a taxpayer's adjusted gross income. Miscellaneous itemized deductions may also be limited by the overall itemized deduction phase-out.

These expenses include employee business expenses, expenses of producing income, expenses related to filing tax returns and certain hobby expenses. Specifically, the miscellaneous itemized deductions available to a taxpayer are:

- Professional society dues;
- Employment-related educational expenses;
- Home office expenses;
- Professional books, magazines and journals;
- Work clothes and uniforms;
- Union dues and fees
- A portion of unreimbursed business-related meal and entertainment expenses;
- Other unreimbursed employee business expenses;
- Employee expenses for which reimbursements are included in income;
- Rental of a safe-deposit box;
- Expenses incurred for tax counsel and assistance;
- Costs of work-related small tools and supplies;
- Investment expenses;
- Fees paid to an IRA custodian; and
- Certain expenses of a partnership, grantor trust or S corporation that are incurred for the production of income.

Additionally, there are some miscellaneous expenses that are subject to the 2-percent of adjusted gross income limitation. These include:

- Bond premium amortization on taxable bonds;
- Gambling losses for the year up to the extent of gambling winnings;
- Casualty and theft losses associated with income-producing assets; and
- Federal estate tax on income in respect of a decedent.

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