Meisel, Tuteur & Lewis, P.C.
Certified Public Accountants
Management Consultants

Thoughts from Outside the Box
OUR PERSPECTIVES

2nd Quarter 2017 Volume 16 Issue 2

Dear Clients and Friends,

It looks like summer is finally here and we remain busy at the firm. People often ask what we do after tax season and I'm happy to explain that we are engaged and hard at work all year round with audits, extended tax returns and consulting. Many of our clients cannot file their personal returns by the April 15th deadline. A good number of our partnership clients don't receive final information from underlying sources until the summer or early fall as well. These reasons, coupled with quarterly and year-end planning and tax projections, no longer make our business seasonal.

We are in a holding pattern with the proposed tax law changes as we wait for the drama in Washington to shake out. We're diligently monitoring the situation and will be sure to update you when appropriate.

On behalf of everyone at MT&L, we wish you an enjoyable and relaxing summer.

Very truly yours,

Michael S. Lewis, CPA
Managing Partner

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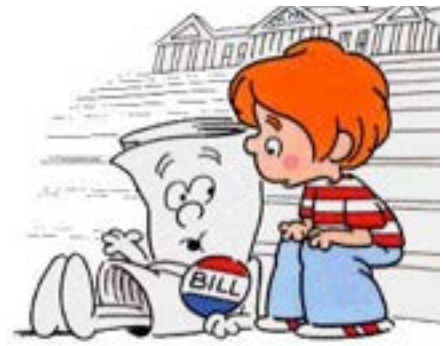
I'm Just a Bill—How Tax Laws are Created

Anthony Pentz, CPA, MST



The media is filled with stories about the proposed tax reform that President Trump would like to implement. Everywhere you turn there seems to be an article about how one group of taxpayers will benefit from one provision while others will be negatively impacted by another. Rest assured, we are always paying close attention to proposed and actual tax law changes and how it impacts each of our clients.
It's important to remember, however, that for a new law to be passed, a number of steps need to occur. It is rare that anything is signed without a number of changes and concessions occurring in the process. With this in mind, we thought it would be beneficial to discuss the process in which new tax laws are created.

Federal tax changes are first proposed as a tax bill in the U.S. House of Representatives. The House Ways and Means Committee must reach an agreement regarding the legislation and draft the proposed law. At this point, the bill goes to the entire House of Representatives for consideration. It can be debated and amended in the House before final approval.

Once approved by the House of Representatives, the bill goes to the Senate where it is reviewed by the Senate Finance Committee. The Committee holds hearings to determine whether the bill is acceptable as is, or if it should be amended before being brought to the full Senate. Once it is presented to the full Senate, the bill again can be debated and amended before it is voted on for approval by Senate.

If the bill is passed by Senate without any changes to the version approved by the House, the bill then goes to the President. However this is often not the case. Assuming Senate has amended the version of the bill previously approved by the House, then the amended bill goes back to the House. If the House chooses, they can adopt a motion to disagree with the amendments made by the Senate. This would result in a Conference Committee of both Senate and House members being formed to compromise on the two versions of the

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Inside this Issue

Know the Tax Implications Before You Rent

Ryan McElwaine, CPA

Summer is around the corner, which means it's time for long weekends at the beach and vacations around the world. For those who choose to capitalize on the opportunity to earn extra income during the summer months, sharing-economy services like Airbnb provide a quick and easy way to rent your residence to vacationers who don't want to deal with the hassle (and price) of booking a hotel. If you do decide to sign up with a service like Airbnb, you should understand the tax implications and benefits of the income you earn.

Any income received from renting a personal residence or unit is usually taxable and can be treated as business income or rental income, determined by the specific services you provide. Generally, if you provide substantial services in connection with the rental, such as regular cleaning and room services, or if you're considered a real estate professional, the income can be classified as trade or business income. That needs to be reported on Schedule C, *Profit or Loss from Business*, of Form 1040. If you're simply providing basic amenities such as heat, water, electricity and trash collection, report the income on Schedule E, *Supplemental Income and Loss*, of Form 1040. One benefit of using a service such as Airbnb is they make the rental process easy, managing all of the bookings and collecting payment. At year-end, they simply send you and the IRS a 1099-MISC, *Miscellaneous Income* form, which provides the gross income from your rental for the tax year.

There is one circumstance where rental income received by the host is not taxable. If you rent your home or other residence for less than 15 days during the year and also use that unit yourself during the year, you do not have to report and pay tax on the rental income you earn. This is informally known as the "less-than-15-day-rule." One thing to note regarding application of the 15-day rule: while you don't have to report the rental income received, you also cannot deduct any rental expenses incurred during the tax year this occurs.

If, however, you use the unit during the tax year for personal purposes for more than the greater of 14 days or 10% of the total fair rental days, the 15-day rule does not apply and you must report all rental income. In these instances, you are allowed to deduct expenses directly related to maintaining the rental, such as supplies, utilities, repairs and cleaning services, as well as insurance, taxes and mortgage interest, regardless of where you report the rental activity on Form 1040 (Schedule C or E). These expenses are to be separated and allocated based on personal use of the property versus rental use. The allowable portion of rental expenses are deducted on Schedule C or E, while the allowable portion of personal expenses such as home mortgage interest and real estate taxes are deducted on Schedule A, *Itemized Deductions*, assuming you're able to itemize on your return. The portion of allowable rental expenses is determined by multiplying the total expenses by the ratio of the number of days the unit is rented a fair rental to the number of days the unit is used for personal purposes during the tax year.

The possibility of enjoying the nice weather and also creating additional income is enticing. So if you decide to rent your residence or property during the summer, be aware of the tax implications and benefits of doing so. If you're uncertain about your particular situation, don't hesitate to contact your MT&L advisor. ■

> *"Ask yourself if what you're doing today is getting you closer to where you want to be tomorrow."*
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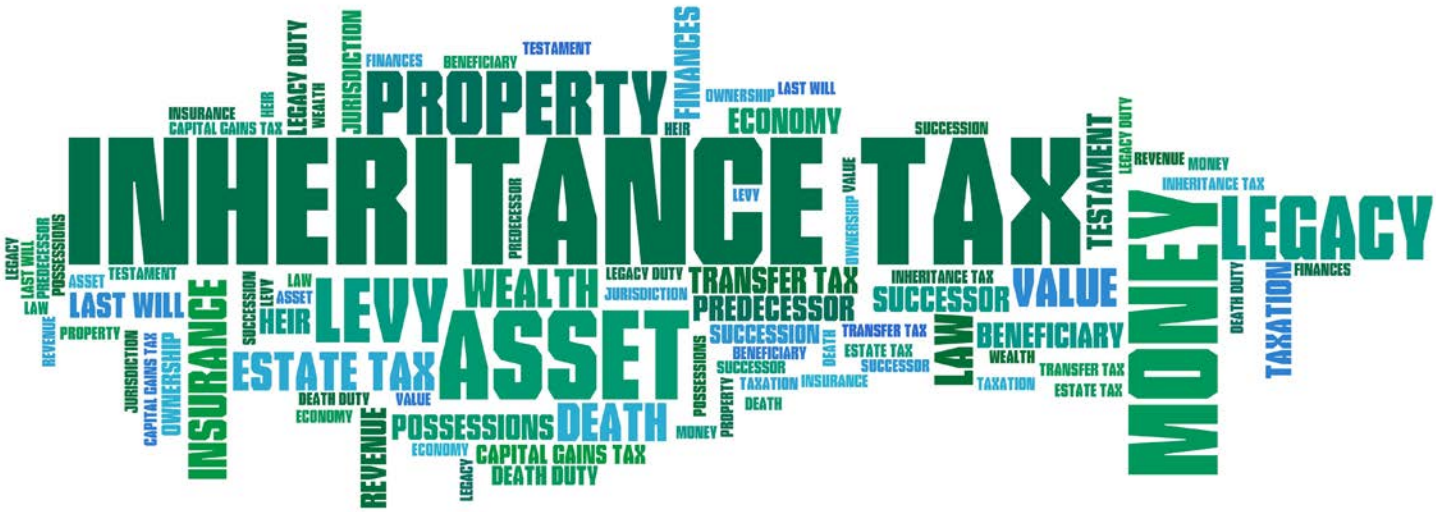

Tax Implications to be Aware of When Leaving or Receiving an Inheritance

Andrew R. Fink, CPA, MST, AEP®

Estate planning can be a complicated matter and is often ignored by many. There are many estate inheritance and income tax issues to consider when drafting your will, creating trusts, and deciding how and when to pass on your assets.

For example, there are pros and cons to be aware of when choosing whether to gift assets to your beneficiaries or leave them as an inheritance. There are also things to consider if you wish to leave assets to a charity as a philanthropic bequest, versus leaving them to a family or friend beneficiary.

Below are a few other areas to be aware of.

Upon the death of an individual, the assets in his/her estate are valued at the date of death market value. Therefore, the beneficiary of the estate value receives a step-up basis for the assets received. In addition, the holding period is automatically considered "long-term." For example, if a parent who dies on April 30, 2017 purchased a house for $125,000 in 1980, and the property is worth $600,000 at their date of death, the basis to the beneficiary (i.e., their son or daughter) is $600,000. If the parent purchased Amazon stock in November 2016 for $750 per share and its value is $950 when they died on April 30, 2017, the basis to the beneficiary is $950 and is considered long-term even if it is sold within 12 months of the purchase date.

Assets such as cash, stock, bonds, real estate or collectibles are not taxable when inherited; but the dividends, interest, net rental income, and gain or loss on the sale of these assets is included in the beneficiary's income in the year of the transaction. Life insurance proceeds are also not taxable on the receipt of the redeemed policy, but any interest or dividend earned on the policy from the time of death of the insured to when the policy is redeemed is taxable to the beneficiary.

Another category of inherited assets that generate "deferred taxable income" to the deceased has a different tax effect to the beneficiary of these assets. Included in this category are (a) IRA or other qualified plans, (b) annuities, (c) savings bonds and (d) installment sales.

In this category, the estate value of the assets is the date of death value. The beneficiary, though, is taxed on the full annual distribution from the IRA or qualified plan as regular income. For annuities, the beneficiary takes the decedent's basis, but any amount in excess of the amount received of the decedent's basis is taxable to the beneficiary. For installment sale notes, the payments to the beneficiary include the return of the cost of the assets, which is not taxable, the portion from prior sale that is taxable as capital gain, and taxable interest on the note. For savings bonds, the redemption includes the return of investment costs—for example, $50 on a $100 bond—and the deferred interest earned, which would be taxable as U.S. interest.

As you can see, there are numerous rules to be aware of when leaving and receiving an inheritance. An accountant or estate planning professional can help you understand the intricacies of these decisions and how it may impact your overall estate plan. ■

An Inside Look

Employee News

Congratulations to **Tom Wargacki** and his wife Julie, who welcomed daughter Maeve Constance on April 24. She weighed 8 pounds 14 ounces.

Congratulations to **Andrew Fink** on being nominated by the Board of Directors of the Estate Planning Council of Bergen County to be an Accredited Estate Planner® (AEP®). Nominees must meet many standards, including: hold certain designations, significantly engaged in estate planning activities, in good standing of the Estate Planning Council, have 15+ years of experience in estate planning, recognized in the community as an exemplary estate planner, and adhere to the National Association of Estate Planners & Councils (NAEPC) Code of Ethics. Andrew is past president of the council, which has been awarded by the NAEPC for the highest honor of Excellence two years in a row.

Congratulations to **Ryan McElwaine** on earning his CPA license.

Congratulations to **Shane Orbach**, his wife, Ana, big sister Isabella, and big brother Gabriel on their newest addition. Daniel was born on June 7 and was 8 pounds 13 ounces and 20 inches long.

Congratulations to **Karina Brito** on her engagement to Justin Coto. A 2019 fall wedding is being planned. ■

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I'm Just a Bill—How Tax Laws are Created

bill. Once a compromised version of the bill is produced, it will again go back to both the House and Senate for vote. If the compromised version is approved by both, the bill then goes to the President.

Once the bill gets to the President, he or she can either sign it into law or veto it. If the President decides to sign the bill, then the bill becomes a law. If vetoed, the bill goes back to the House where they can either choose to change the bill to address the areas that caused the President to veto, or Congress can attempt to override the veto with a two-thirds vote of each house. If changes are made to the bill, the process starts all over again.

As you can see, there are many opportunities for tax proposals to change before they eventually become a law. It is common for many of the provisions in early drafts to change significantly during the process. We will continue to monitor developments and keep you informed about issues that we feel affect you if and when a new tax law is signed. ■

"There is no substitute for hard work. Always be humble and hungry."

- Dwayne Johnson

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Thoughts from Outside the Box

OUR PERSPECTIVES

What Are Your Chances of Being Audited?

William Schwarz, CPA, MST

The Internal Revenue Service (IRS) has issued its annual data book providing statistics on IRS activities from October 1, 2015 to September 30, 2016. The book reports on returns filed, taxes collected, enforcement, taxpayer assistance and the IRS's budget and workforce. Included in this information is how many tax returns the IRS audited and what categories of returns are being focused on. Analysis of these numbers provides some indication of your chances of being audited.

During Fiscal Year (FY) 2016, the IRS examined 0.6% of all returns filed in Calendar Year (CY) 2015, about 0.7% of all individual income tax returns filed in CY 2015, and 1.1% of corporation income tax returns (excluding S corporation returns). Overall, in FY 2016, individual income tax returns in higher adjusted gross income (AGI) classes were more likely to be examined than returns in lower AGI classes.

Of the 1,034,955 individual income tax returns audited in FY 2016, roughly 36.7% were selected for examination on the basis of an earned income tax credit (EITC) claim. Only 23.6% of the individual audits were conducted by revenue agents.

The balance of the audits (76.4%) were correspondence audits. The following are selected audit rates:

- For business returns (for individuals not claiming the EITC or farm income) showing total gross receipts of $100,000 to $200,000, 2.2% of returns were audited in FY 2016, down from 2.5% in FY 2015.

- For business returns (for individuals not claiming the EITC or farm income) showing total gross receipts of $200,000 or more, 1.9% of returns were audited in FY 2016, a decrease from 2% in FY 2015.

- Of the returns showing farm (Schedule F) income, 0.4% were audited in FY 2016 versus 0.3% in FY 2015.

- For non-business returns showing total positive income of $200,000 to $1 million, 1% of returns were audited (down from 1.8% for the previous year); for business returns, 2.3% of such returns were audited (down from 2.9% for the previous year). In general, total positive income is the sum of all positive amounts shown for the various sources of income reported on the individual income tax return and, thus, excludes losses.

- For FY 2016, the audit rate for returns with total positive income of $1 million or more was 5.8%, down from the 9.6% rate for FY 2015.

For all corporate returns (other than Form 1120-S), the audit rate in 2016 was 1.1% (down from 1.3% in the previous year). For small corporations with balance sheet returns showing total assets of $250,000 to $1 million the rate was 1%; for $1 to $5 million the rate was 1%; and for $5 to 10 million the rate was 1.6%. For FY 2015, the percentages were, respectively, 1.2%, 1.1%, and 1.5%.

For large corporations with returns showing total assets of $10 to $50 million the audit rate was 4.7%; for $50 to $100 million the rate was 10.3%; for $100 to $250 million the rate was 11.1%; for $250 to $500 million the rate was 12.2%; for $500 million to $1 billion the rate was 13.9%; for $1 billion to $5 billion the rate was 19.5%; for $5 billion to $20 billion the rate was 35.7%; and for $20 billion or more the rate was 78%. For FY 2015, the percentages were, respectively, 5.8%, 11.3%, 14.2%, 14%, 17%, 23.6%, 36.1%, and 64%. ■

Is It Really the IRS, or Another Scam?

William Schwarz, CPA, MST

The Internal Revenue Service (IRS) has created a special page on its website (https://www.irs.gov) to help you determine if a person visiting your home or place of business claiming to be from the IRS is legitimate or an imposter. With phone and in-person scams continuing to run rampant, the IRS wants you to understand how, when, and why you might be contacted. Knowing how they operate will help you determine whether you have been contacted by a true IRS employee.

Generally speaking, the IRS initiates most contacts through regular mail delivered by the U.S. Postal Service. However, employees do in fact make official, sometimes unannounced, visits to taxpayers as part of their routine casework.
The IRS notes that a legitimate IRS representative will not:

- Demand you use a specific payment method, such as a prepaid debit card, gift card, or wire transfer. Nor will they ask for a debit or credit card number over the phone.
- Demand you pay a tax bill without the opportunity to question or appeal the amount they say is owed. Generally, the IRS will first mail a bill before phone or in-person contact is made. You should also be advised of your rights during a contact.
- Threaten to bring in local police, immigration officers, or other law-enforcement to have you arrested for not paying. The IRS cannot revoke your driver's license, business licenses, or immigration status. Threats like these are common tactics that scam artists use to trick victims into paying.

In addition, if an IRS agent does visit you, they will always provide two forms of official credentials, called a pocket commission and a HSPD-12 card. The HSPD-12 is a government-wide standard for secure and reliable forms of identification for Federal employees and contractors. As a taxpayer, you have the right to see these credentials.

Use of Private Collection Agencies: Adding to the problem, the IRS has started using private collection agencies (PCAs). Even with the use of PCAs, there should be no surprise phone calls. The IRS will always send a letter first, providing the name of the PCA assigned to your case. Once the letter from the IRS is sent, the PCA will then send its own letter confirming they have been assigned to the case. Both of these letters should confirm the details of the debt and contain a specific authentication number assigned to you.

There are only four PCAs contracted with the IRS. They are as follows:

- CBE Group, based in Cedar Falls, Iowa
- Conserve, in Fairport, New York
- Performant, in Livermore, California
- Pioneer, in Horseheads, New York

If the case does progress to a phone call, the PCAs are prohibited from using robocalls or pre-recorded messages to contact you. It will always be a live person who will use the authentication number assigned to you.

Lastly, these PCAs are authorized to discuss payment options. However, you will never be asked to pay the company directly. Instead, the agent must direct you to either pay the IRS electronically at IRS.gov/payments, or send the IRS a paper check, made payable to the U.S. Treasury.

If you have been contacted by the IRS and need advice, don't hesitate to contact your Meisel, Tuteur & Lewis professional. ■