RRBB ACCOUNTANTS + ADVISORS

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RRBB Announcements

RRBB Happenings

We are coming down the home stretch of tax season for this year, and things are going great. (Busy, but great.) Thank you in advance to all our wonderful clients and the new folks they continue to refer us to. And while we've been busy filing tax returns, *NJ Biz* came out with “New Jersey's Top 50 Accounting Firms for 2017.” RRBB is moving up. We ranked #28 on that list, up from #32 last year. This is also thanks again, to our terrific clients who continue to allow us to help them and who continue to send us other great people and companies to work with.

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Make Tax Plans for Vacation Home Rentals

How to maximize the tax benefits

The summer rental season is about to kick off. If you own a vacation home in a resort area that you rent out while your family is not using it, you may be in line for valuable tax deductions. In fact, you might even qualify for a tax loss on the deal, but you must be careful to observe the complex tax rules.

To offset the income you receive from tenants, you can typically deduct the costs attributable to the rental, including mortgage interest, property taxes, repairs, utilities, insurance, etc. But there is a limit to this tax generosity: Under the passive activity loss rules, you can use losses from a rental activity only to offset losses from other passive activities.

However, if you are an active participant in the rental (e.g., you make management decisions), the tax consequences depend on your income level and the extent of your family's personal use. There are three basic rules to follow:

1. If your income does not exceed $100,000, you can use the loss to shelter up to $25,000 of your salary and other income as long as you keep your personal use to a minimum. Your family's personal use cannot exceed the greater of 14 days or 10% of the rental time. On the downside, when you keep your personal use below these limits, you lose a portion of your mortgage interest deduction (the portion allocable to your personal use).

2. If your income exceeds $150,000, the tax law says you cannot qualify for the $25,000 loss write-off. Basically, your total rental deductions cannot exceed your rental income, regardless of the amount of your personal use. However, if your personal use is greater than 14 days or 10% of the rental period, you are entitled to an additional deduction: the portion of your mortgage interest you do not claim as a rental expense.

3. If your income is between $100,000 and $150,000, things are not as clear-cut. The $25,000 loss write-off is gradually phased out in this income range. The closer you are to the $150,000 level, the more likely it is you will get little in the way of a

loss write-off. So you will probably want to increase your personal use—the same strategy for those with incomes above $150,000. This way, you will be able to deduct more of your mortgage interest.

Conversely, if you are closer to the $100,000 level, most of your loss write-off will be intact. Therefore, try to keep your personal use below the 14-day or 10% mark.

Note: There is a unique tax opportunity if you rent out the home for two weeks or less during the year. You do not have to report any income or expenses for this short period on your 2017 tax return. As a result, all of the rental income is effectively tax-free.

The tax rules in this area are extremely tricky, and it is easy to slip up. Do not hesitate to seek professional assistance with respect to vacation home rentals.

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Business Driving Deductions: A Fork in the Road

Compare actual expenses with flat-rate method

Did you use your vehicle for business driving in 2016? Generally, you can deduct expenses on your tax return in one of two ways: the actual expense method or the IRS-approved standard mileage rate. Here is a brief comparison:

1. Actual expense method: As the name implies, you can deduct actual expenses attributable to business use of the vehicle, including gas, oil, tires, insurance, repairs, licenses, registration fees and so on. Also, you may claim a depreciation deduction for the vehicle, based on the percentage of business use. For instance, if you use an automobile 80% for business use, you are entitled to a depreciation deduction of 80% of the allowable amount.

Although the annual depreciation deductions are limited by “luxury car” rules, there is an extra tax reward for clients who placed a vehicle in service in 2016. Due to the Protecting Americans from Tax Hikes (PATH) Act of 2015, you can claim 50% “bonus depreciation,” effectively adding $8,000 to a first-year depreciation deduction. Under the PATH Act, the maximum first-year deduction for a passenger vehicle for 2016 is $11,160. (As of this writing, the figure for 2017 has yet to be announced.)

However, if you use the actual expense method, you must account for every single expense incurred, as well as maintain detailed records for every business trip. This includes the mileage for each business trip, the date of the trip, the destinations, the names and relationships of the business parties involved, and the business purpose of the travel.

2. Standard mileage rate: Alternatively, you can use the standard mileage rate approved by the IRS. This figure is updated every year. For 2016 returns, the flat rate is 54 cents per business mile, plus related tolls and parking fees. (It decreases to 53.5 cents per business mile in 2017.)

With this method, you do not have to account for all your actual expenses, but you still must keep records of the mileage for each business trip, the date, the destinations, the names and relationships of the business parties, and the business purpose of the travel. Finally, the standard mileage rate cannot be used if you

- operate cars for hire (e.g., taxis and limos);
- use five or more cars at a time (e.g., fleet operations);
- have claimed an accelerated depreciation deduction for the vehicle in the past;
- have claimed a Section 179 deduction for the vehicle in the past;
- have claimed actual expenses after 1997 for a vehicle that is leased; or
- are a rural mail carrier who has received a qualified reimbursement.

The actual expense method will often produce a larger deduction, especially if you drive few business miles during the year, because you benefit from the depreciation allowance based on business use. But you must have the records needed to support your claims.

Have your professional tax adviser help you crunch all the numbers. The difference can amount to hundreds or even *thousands of tax dollars on your 2016 return.*

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Don’t Ignore the Embezzlement Threat

Small-business owners must remain alert

It seems to be in the news every other day: A trusted longtime employee is found guilty of embezzling money from his or her employer. This may give you momentary pause, but then it is likely that you will simply continue to go about your business. After all, this cannot happen to you—can it?

Of course it can. Employee embezzlement accounts for the majority of ordinary business losses suffered by employers each year. According to one study conducted in 2016, the average loss was more than $800,000. And small businesses were not immune. Surprisingly, four of every five organizations that were victimized had fewer than 100 employees, while just under half had fewer than 25 employees.

How can you best protect your company? A good place to start is with an examination of your bookkeeping procedures. Be sure to completely separate the accounts payable from the accounts receivable. In addition, have at least two employees handle the payroll—one to write the checks and the other to distribute them. If only one person is assigned both of these critical jobs, it may create an irresistible temptation to embezzle.

Furthermore, the owner of a small business should approve all checks over a certain amount. Payments should be made with an original invoice, not a copy. Have all bank statements reconciled and audits performed periodically.

Even with these safeguards in place, there is no guarantee that you will not be victimized. What should you do if you find out an employee has embezzled from the company? Here are a few suggestions:

- Consult an attorney to find out the civil and criminal legal remedies that may be available to you. For instance, you might sue the employee to recover the embezzled money.
- Contact the authorities. Frequently, owners feel partly to blame for allowing the theft to take place, but hiding it does no good. In most cases, the employee will then move on to the next victim, and you will be left holding the bag.
- Try to recover the funds. Reporting the crime does not mean you will be reimbursed in full. Before paying claims, insurance companies want solid proof of embezzlement, which is not always easy to provide. For example, when inventory is stolen, it is hard to show that the loss is actually theft and not an inventory mistake.
- Notify the IRS about the embezzlement. This becomes an added incentive for the employee to make restitution, because embezzled funds are considered to be taxable income. If you report the crime to the IRS, the employee will owe tax on the total amount stolen. This amount will be reduced to the extent that the employee makes restitution. If your business involves sensitive matters, or security is a critical issue, you might obtain a bond to cover your employees.

Be aware of the possibility of employee embezzlement. Do what you can to address potential problems before they occur. Finally, keep your eyes and ears wide open at all times.

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Reach Into This Grab Bag of Deductions

How to write off miscellaneous expenses

As we near the end of tax filing season, you might be looking to increase the number of itemized deductions you can use to offset highly taxed ordinary income. What about the grab bag of expenses known as miscellaneous expenses? If you qualify, you might be able to deduct a portion of those expenses on your 2016 tax return.

Background: Miscellaneous expenses are generally not big-ticket items (with certain key exceptions), but they can add up into a sizeable deduction at tax return time. The main hurdle is your annual deduction is limited to the excess above 2% of your adjusted gross income (AGI) for the year.

For instance, suppose that your AGI for 2016 is $100,000 and you incurred $1,975 of miscellaneous expenses during the year. In that case, your deduction is zero because you didn't clear $2,000, which is 2% of AGI. However, if you have $3,000 in miscellaneous expenses, you are able to deduct $1,000.

Miscellaneous expenses are generally attributable to one of two categories: production-of-income expenses or employee business expenses. Here is a brief overview:

1. Production-of-income expenses: This group includes expenses related to the production of income through investments, financial planning, retirement planning and tax assistance. Although this list isn't all-inclusive, some common examples are the cost of renting a safe deposit box in which to store non–tax-exempt securities; accounting fees and legal fees to produce or preserve income; custodial fees for income-producing property and IRAs; fees paid to collect interest or dividends; hobby expenses (up to the amount of hobby income); fees for investment and tax counsel; appraisal fees for charitable contributions and casualty losses; and the cost of services, periodicals, manuals and other materials related to tax assistance.

Note that the cost of having your tax return prepared by a professional is deductible as a miscellaneous expense.

2. Employee business expenses: The other main group of miscellaneous expenses consists of unreimbursed employee business expenses. It includes such expenses as dues paid to professional societies, union dues, employment-related education, malpractice insurance premiums, qualified home-office expenses, subscriptions to professional journals and magazines, work clothes or uniforms, cellular phones and home computers (when required as a condition of employment), and qualified travel and entertainment expenses (but only 50% of entertainment costs are eligible for the deduction).

Final words: As is usually the case with taxes, there are several exceptions to these general rules, so it is recommended that you obtain expert tax advice. Remember that the cost of tax assistance itself is deductible as a miscellaneous expense, subject to the 2%-of-AGI limit.

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Facts and Figures

Timely points of particular interest

Estate Taxes—Be aware of significant estate-tax changes in individual states. Beginning in 2017, New Jersey is increasing its estate-tax exemption, before repealing the estate tax in 2018. Several other states—including Maryland, Minnesota and New York—are increasing their exemptions, while Rhode Island and Washington index their figures. Other states—Delaware, Hawaii and Maine—will match the federal exemption of $5.49 million in 2017.

Business Alliances—How can you grow your business in 2017? One idea for owners and managers to consider is a business alliance. This is a formal business arrangement between two or more organizations to achieve shared business objectives. It includes joint ventures, franchising, cross-licensing and cross-marketing activities. There are numerous pros and cons to consider, so obtain expert advice.

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Play Your IRA Cards Right

The deadline for filing 2016 tax returns—April 18, 2017—is fast approaching.

Ace in the hole: If you qualify, you (and/or your spouse, if married) can still contribute to an IRA for the 2016 tax year.

Depending on income limits and whether you (and/or your spouse) participate in an employer retirement plan, a contribution to a traditional IRA is partially or wholly deductible for amounts deposited by the tax return due date.

The maximum contribution allowed for 2016 is the lesser of earned income or $5,500 ($6,500 if age 50 or older).

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RRBB Accountants and Advisors

SOMERSET OFFICE
265 Davidson Avenue, Suite 210
Somerset, NJ 08873-4120
908-231-1000

MAPLEWOOD OFFICE
111 Dunnell Road
Maplewood, NJ 07040
973-763-6363

info@rrbb.com
www.rrbb.com