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Monthly Updates

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Is Your Travel Day Personal or a Tax-Deductible Business Day?

When you travel to a business location where you spend the night, you are in travel status. But will the tax rules make this a business or personal night?

The rules also affect your costs during the day. When you have an overnight business travel day, you generally deduct your costs of sustaining life for the day, such as breakfast, lunch, dinner, snacks, drinks, lodging, and taxis.

Business days also are important in determining how much of your travel cost you may deduct. For example, on a seven-day trip to London, one business day makes the airfare deductible.

Yep, you heard that right. Six personal days and one business day in London—you deduct 100 percent of the airfare.

Transportation days are the trickiest days.

Days spent traveling to or returning from a destination outside the United States are treated as business days—provided you use a "reasonably direct route" and you don't engage in "substantial diversions for non-business reasons" that prolong your travel time.

If you don't use a reasonably direct route, you count as business days the amount of time that a reasonably direct route would have taken.

Similarly, if you engage in substantial non-business diversions, you count as business days the amount of time it would have taken without such diversions.

These rules apply to whatever mode of transportation you use. So if you travel by airplane and don't take a reasonably direct route, you count as business travel days the number of days an airplane would take to reach your destination by a reasonably direct route. The same is true for travel by car or cruise ship.

Once you are at your business travel destination, if a Saturday, a Sunday, a legal holiday, or another reasonably necessary standby day intervenes while you endeavor to conduct your business with reasonable dispatch, you treat such a day as a business day.

2 Ways to Fix Tax Return Mistakes Before the IRS Discovers Them

If you made an error on your tax return, don't worry—there are two easy ways to fix it:

1. A superseding return

2. A qualified amended return

A superseding return is an amended or corrected return filed on or before the original or extended due date. The IRS considers the changes on a superseding return to be part of your original return.

A qualified amended return is an amended return that you file after the due date of the return (including extensions) and before the earliest of several events, but most likely when the IRS contacts you with respect to an examination of the return. If you file a qualified amended return, you avoid the 20 percent accuracy-related penalty on that mistake.

When it comes to the IRS, an ounce of prevention is worth a pound of cure. If you made a mistake, fix it as soon as you know about it, which will save you penalties, increased interest accruals, and the headache of an IRS review of your return.

Find the Winning Tax Law for Your IRS Audit

If you are suffering or about to suffer an IRS audit, you should know how your tax positions stack up against the IRS examiners' positions.

In most cases, you are discussing the facts, not the law, and you prove your facts with receipts, canceled checks, and logbooks. Once you get into the law, the rules of engagement work pretty much as described below.

Here are three general rules on the persuasiveness of tax documents:

- Statutes and regulations are highly persuasive with both the courts and the IRS.
- The next-best authority with the courts is prior case law.
- The next-best authorities with the IRS are IRS documents. But as you'll see, IRS documents range from very strong to very weak.

Your tax dispute always begins with the IRS.
At the earliest stages of the audit, you work with auditors and agents whose knowledge of the law comes primarily (or solely) from IRS documents, not statutes or court cases. As you advance your case within the IRS, you deal with supervisors and officers who are more knowledgeable and pay more attention to the code, regulations, and (to a lesser extent) court cases.

Throughout the audit, one thing remains constant: IRS documents remain hugely important at all levels within the IRS.

After the tax code and regulations, the first type of official IRS publication is a **revenue ruling**. The revenue ruling reads like a condensed court case and describes how the IRS applies the law to a particular set of facts.

The second type of official publication is the **revenue procedure**. The IRS uses the revenue procedure to administer the law by updating dollar amounts for inflation and by explaining procedures for making elections or filing forms.

The third type of official publication is the **acquiescence** or **non-acquiescence**. At its discretion, the IRS can issue a statement indicating its agreement (acquiescence) or disagreement (non-acquiescence) with a Tax Court ruling.

Last, you'll find **notices** and **announcements** that describe the IRS's official position on recent issues. You'll also find private letter rulings and technical advice memoranda that carry weight with the IRS.

The IRS also publishes IRS forms, instructions, publications, and FAQs (guides). The guides are less technical than official pronouncements, and they don't include citations. The IRS writes the guides in clear terms so that non-professionals can easily understand them.

Most tax disputes begin and end with the IRS. So where do court cases fit into your legal research? Court cases matter at the IRS level for two reasons:

- At the highest level of IRS review (appeals), IRS officers consider court cases.
- Court cases usually describe all the statutes, regulations, and other important IRS documents you need in order to support your case. Plagiarizing court cases is not only within the rules for engagement with the IRS but also a great strategy!

Once your tax dispute leaves the IRS and enters court, your best sources of tax authority are statutes, regulations, and prior court cases.

Garage Space as a Home Office

Do you claim a tax deduction for a home office?

Should you include or exclude your garage space in your calculations of business-use percentage?

Ronald Culp earned an office deduction for 78 percent of his home. That's a nice percentage, but what's really interesting is how the court looked at Mr. Culp's home in deciding that 78 percent business use.

Here's how the court made the computation that produced the 78 percent business use of Mr. Culp's home:

- The court counted the garage as office space because it could find no basis in law or fact for excluding it. (The garage held two printing presses and a large paper cutter that were integral to Mr. Culp's business.)

- Regarding the utility room in the basement where the water heater and furnace were located, the court said that this space failed the exclusive business-use standard for the home-office deduction and that such space counted as personal space.

- The attic, which measured 1,128 square feet, contained only 100 square feet of usable space. The court ruled that the other 1,028 square feet were not functional, because that footage was not accessible due to the slope of the roofline and/or the lack of flooring.

Observation. The printing took place in the garage, but the IRS said that such space was not usable space, and the IRS did not want it counted in the calculations. The taxpayer and the court agreed that the space should be counted in the calculations. Will this be true for other garages?

According to the court's description in a different case, Gene Moretti rented a 5.5-room house consisting of two bedrooms, a den, a living room, a dining room, and a half-kitchen. The court noted that "the house also had a garage" and that Mr. Moretti claimed business use of the den, living room, dining room, and garage.

The court concluded that only the den met the regular and exclusive use requirements for qualification as an office in the home.

To calculate the business percentage, the court used the number-of-rooms method and calculated that one room (the den) of the 5.5 rooms represented the business-use percentage of this home. The court ignored the garage even though Mr. Moretti tried to claim it as office space.

The two-garage case. In an effort to save time, the court tried two separate day-care cases together. Each case involved the use of a garage.

In both of these court cases, the IRS excluded the garages from its computations.

The court took the opposite view. First, it included both garages in the business-use-of-home

calculations. Although it found that one garage met the requirements for the home-office deduction and one garage did not, the key point is that both garages were included in the calculations.

In conclusion, we see in these court cases that the IRS often excluded the garages, whereas the courts were eager to include them. Since you start any disagreement over your tax return with the IRS, this should work to your advantage.

You might think that the rules are a little unclear in this area. That's true.

The science involved in tax law is finding cases, rulings, procedures, and publications that support your position. The art form is putting your spin on the deduction. That's all you can do when neither the law nor the regulations give clear advice.

Are you Real Estate Professional and own rental properties?

Let me tell you about a recent audit of Lisa and Jimmy. They had a very unsatisfactory visit with the IRS. The auditor examined their three rental properties, disallowed their losses, and told them to expect a tax bill for $55,000.

Current score: IRS $55,000 ahead.

But one good thing happened during the visit. The IRS agreed that Lisa was a real estate professional.

The bad thing was that the IRS said that Lisa did not materially participate in the rentals, because the more than 750 hours shown in her logbook included what's called investor time.
With this, the IRS examiner said that although Lisa is a real estate professional, she failed to materially participate in the properties because she had fewer than 500 hours of material participation.

Properties

Lisa and Jimmy's rental properties include

- a condo rented on a month-to-month lease,
- a single-family home rented on a month-to-month lease, and
- a vacation cabin rented on a one-week basis for 20 weeks a year.

They have no personal use of the rentals.

We started by explaining that the 500 hours are not relevant. That 500-hour rule is just one of seven possible material participation tests that you find in IRS Reg. Section 1.469-5T(a)(1).

Condo. To show the IRS that Lisa and Jimmy materially participated in the condo, we used the "more than 100 hours" test. This test requires that Lisa's and Jimmy's participation be more than 100 hours and not less than participation by any other individual.

We used the *Pohoski* case as our position. In this court case, the taxpayer had to count only the time that front-desk personnel actually spent on his unit, not the total time that they manned the desk. The IRS accepted that Lisa and Jimmy met that test.

Single-family home. Since Lisa and Jimmy did everything in connection with this rental, the IRS had no choice but to allow material participation under the "substantially all" test (one of the seven tests).

Vacation cabin. Lisa did all the work for the vacation cabin, except for that done by a housekeeper who spent three to four hours for each of the 20 weeks that the vacation cabin was rented (say 3.5 x 20 weeks, for a total of about 70 hours of housekeeping). We won material participation here because Lisa's and Jimmy's combined efforts were more than 100 hours and more than the housekeeper's 70 hours.

The combination of our work and Lisa's and Jimmy's good tax records enabled Lisa and Jimmy to obtain a "no change" letter—meaning that the $55,000 IRS claim was gone.

Did you take a coronavirus distribution (CVD) during 2020?

Did you take a coronavirus distribution (CVD) of up to a combined limit of $100,000 from one or more of your traditional IRAs in 2020?

You can recontribute the CVD amount(s) back into one or more traditional IRAs within three years of the withdrawal date(s). You treat each withdrawal and later recontribution within the three-year window as a federal-income-tax-free IRA rollover transaction. That's the tax advantage.

The non-tax advantage is that there are no restrictions on how you can use CVD funds. You can use the money to pay bills and recontribute later—within the three-year window—when your financial situation permits. You can help out your adult kids now and recontribute later. Whatever.

Key point. The favorable tax treatment applies equally to CVDs taken from garden-variety traditional IRAs, SEP-IRAs, SIMPLE-IRAs, and employer retirement plans that allowed CVDs.

Unfortunately, you must put up with some potentially awkward interim tax consequences before you arrive at the tax-free-rollover-equivalent outcome. The interim tax consequences can diminish the cash-management advantages of the CVD deal, and they require filing amended returns to gain federal-income-tax-free treatment.

You always have the option of simply keeping all or part of your CVD money. You'll have taxable income from the CVD amount that you don't recontribute.

Good news. Regardless of what you choose to do with your CVD, you won't owe the dreaded 10 percent early withdrawal penalty tax that generally applies to traditional IRA withdrawals taken before age 59 1/2. CVDs are completely exempt from the penalty tax.

The same is true for the SIMPLE-IRA. IRS Notice 2020-50 clarifies that CVDs taken from a SIMPLE-IRA are exempt from the 25 percent early distribution penalty tax that generally applies to SIMPLE-IRA withdrawals taken before age 59 1/2.

More good news. When you recontribute a CVD amount within the three-year window, it's deemed to be a direct trustee-to-trustee transfer that's exempt from the one-IRA-rollover-per-year limitation.

Bad news. According to IRS Notice 2020-50, beneficiaries of inherited IRAs can receive CVDs as long as

- they are eligible individuals,
- they can follow the three-year ratable inclusion rule to report taxable income from CVDs, and
- their CVDs are exempt from the 10 percent early distribution penalty tax.

But only an IRA CVD that is otherwise eligible for tax-free rollover treatment can be recontributed. Therefore, CVDs received by beneficiaries of inherited IRAs (other than the surviving spouse of the IRA owner) cannot be recontributed. So, no tax-free-rollover-equivalent deal for those folks. Sorry.

Advanced Child Tax Credit

July 15, 2021 is when the Advanced Child Tax Credit program will go into effect. The much-anticipated child tax credit program is still broadly misunderstood by most parents.

No wonder there is confusion as it is not common for taxpayers to get monthly payments from the government simply for having children. Yet that is what is about to happen across the country. For children ages 5 and under, the monthly credit is $300. For children ages 6 to 17, the monthly payment is $250. This means for a family of four with children ages 4 and 8, parents will get $300 and $250 per child respectively.

Qualifying for the credit depends on the parents modified adjusted gross income (MAGI). That is where some of the confusion arises. Some taxpayers are not sure they qualify while others aren't sure if they should opt out.
The good news is that there is still time to do some last-minute planning, though even with a successful rollout, some potential administrative challenges remain.

A key question is whether the taxpayer wants to receive the first half of the credit monthly or wait until the 2021 tax return filing to obtain it. In a recent survey, Ally Bank found that 67% of eligible taxpayers expect to take monthly payments of the credit.

Those in this group should log onto the Advance Child Tax Credit Eligibility Assistant on the IRS site. The reason for this is quite simple. It's best to ensure your bank account, address, name, SSN and all other information are updated in the IRS' system to minimize avoidable errors or snags.

For those taxpayers who are not sure they will be eligible for the credit, there is still time to opt out, using the same tool. This might make the most sense for taxpayers who have complex filing situations, such as a divorce or increased income.

Take the money if it's coming to you, but be very, very aware that this is **not stimulus money**, and you will have to pay this back if you aren't entitled to it when it comes time to file your 2021 tax return.

The catch is parents who choose to receive the payments will more than likely get a smaller refund this upcoming tax season. This is due to those people receiving half of the credit early. We suggest parents who don't need the money to make ends meet opt out of the payments.

California – SALT Limitation Workaround

The recent California budget deal reached by the Governor and lawmakers has a workaround for the federal $10,000 State and Local Tax (SALT) limitation for certain passthrough entity owners.

AB 150, which was enacted as part of the budget deal, contains provisions for the SALT workaround elective passthrough entity tax. For the 2021 through 2025 taxable years, qualified S corporations, partnerships, and LLCs doing business in California that are required to file a California return can make an election to pay a passthrough entity tax equal to 9.3% on qualified net income.

The advantage of making this election is that it allows these passthrough entities to pay 100% of the tax at the entity level and reduce the amount of net income passed through to the owners, without the tax on the passthrough income being subject to the $10,000 state and local tax limitation on the federal return.

Stay tuned as this is still new and we are waiting for additional guidance.

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