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Simione Macca & Larrow LLP
Tax-Saving Tips

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How the 90-Day Mileage Log Rule Works for You

Often in an IRS audit, the examiner will ask for your mileage log at the beginning of the audit. If you do not have a mileage log, then you are in danger of losing more than just vehicle deductions. Think about it.

If you don't have a log for mileage, what is the IRS examiner going to think about your other records? Right—he or she is going to think you are a bad taxpayer with bad tax records who needs extra scrutiny.

The IRS says that you may keep an adequate record for part of a tax year and use that part-year record to substantiate your vehicle's business use for the entire year.

To use a sample record, you need to prove that your sample is representative of your use for the year.

By using your appointment book as the basis for your mileage, you not only build great business-use proof, but you also do a great job of showing that your sample vehicle record mirrors your general appointments during the year.

(If you are using a mileage app, synchronize the app results with the appointment book.)

The IRS illustrates two possible sampling methods:

- One identical week each month (for example, the third week of each month)
- Three consecutive months

We don't recommend the one-same-week-each-month method because it is difficult to start and stop a record-keeping process. (Think about how hard it would be to create a habit, undo it, and then create it again—every month.)

The three-consecutive-months log requires only one start and one stop, and you are rewarded with nine months of mileage-log freedom.

For this reason, the three-month log is the superior alternative.

Before getting into the three-month method, we should note that once you have done three months, you are in the habit. You might find it easier to continue all year, rather than stop this year and then have to start again next year.

Here are the basics of how the IRS describes the three-month test:

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- The taxpayer uses her vehicle for business use.
- She and other members of her family use the vehicle for personal use.
- The taxpayer keeps a mileage log for the first three months of the taxable year, and that log shows that 75 percent of the vehicle's use is for her business.
- Invoices and paid bills show that her vehicle use is about the same throughout the year.

According to this IRS regulation, this three-month sample is adequate to prove 75 percent business use.

Will Renting Your Home Destroy Your $250,000 Exclusion?

The days when you could convert your rental property or vacation home to a principal residence and then use the full $250,000/$500,000 home-sale exclusion to avoid taxes are gone.

Here's how the $250,000/$500,000 exclusion works today. You must divide your period of home ownership into two categories—qualified and nonqualified use:

- **Qualified use** means the time you or your spouse uses the home as your principal residence.
- **Nonqualified use** means any time on January 1, 2009, or later in which neither you nor your spouse (or your former spouse) uses the property as a primary residence.

You allocate gain on the sale of your home between the periods of qualified and nonqualified use, and the gain allocated to nonqualified use doesn't qualify for the $250,000/$500,000 home-sale exclusion.

You have one important exception to the nonqualified use definition: nonqualified use does not include rental use during the five-year period that's after the last date you or your spouse used the property as your principal residence.

In other words, if you live in your principal residence for two years or more and then rent it out for three years or less, the rental period is not a "period of nonqualified use," and you qualify for the $250,000/$500,000 home-sale exclusion.

Be Alert to the TCJA Tax Reform Attack on IRA Recharacterizations

When you convert your existing traditional IRA into a Roth IRA and then reverse the transaction by switching the account back to traditional IRA status, the reversal is called a recharacterization in IRS-speak.

If you had a sizable accumulation in your traditional IRA, the ability to convert that traditional IRA to a Roth IRA and also change your mind when things were backfiring was a terrific tax and financial planning break.

But if you make a Roth conversion transaction in 2018 and beyond, the Tax Cuts and Jobs Act (TCJA) eliminates your ability to recharacterize the account back to traditional IRA status. And unlike most of the TCJA changes that affect individual taxpayers, this one is permanent.

Look at the new TCJA rule this way: when you make the decision to convert your *existing* traditional IRA or other retirement plan to a Roth, that's a final decision for 2018 and beyond.

Tax Reform Changes Affecting Partnerships and LLCs and Their Owners

The Tax Cuts and Jobs Act (TCJA) includes several changes that affect partnerships and their partners, and LLCs that are treated as partnerships for tax purposes and their members. Most of the changes are good news. Here are five highlights:

1. Technical Termination Rule Repealed (Good)

Under prior law, a partnership or an LLC treated as a partnership for tax purposes was considered terminated for federal income tax purposes if, within a 12-month period, there was a sale or exchange of 50 percent or more of the partnership's or LLC's capital and profits interests. Fortunately, the TCJA repealed the technical termination rule, effective for partnership or LLC tax years beginning in 2018 and beyond. This is a permanent change.

2. Lower Tax Rates for Individual Partners and LLC Members (Good)

For 2018 through 2025, the TCJA retains seven tax rate brackets for ordinary income and net short-term capital gains recognized by individual taxpayers, including income and gains passed through to individual partners and LLC members. Six of the rates are lower than before. In 2026, the rates and brackets that were in place for 2017 are scheduled to return, but skeptics doubt that will happen.

3. Unchanged Rates for Long-Term Gains and Qualified Dividends (Not Good)

The TCJA retains the 0, 15, and 20 percent tax rates on long-term capital gains and qualified dividends recognized by individual taxpayers, including gains and dividends passed through to individual partners and LLC members. After 2018, these brackets will be indexed for inflation.

4. New Pass-Through Business Deduction (Good)

For tax years beginning in 2018-2025, the TCJA establishes a new deduction based on your share of qualified business income (QBI) passed through from a partnership or LLC. The deduction generally equals 20 percent of QBI, subject to restrictions that can apply at higher income levels.

5. New Limits on Deducting Business Losses (Not Good)

For 2018-2025, the TCJA made two changes to the rules for deducting an individual taxpayer's business losses. Unfortunately, the changes are not in your favor.

For tax years beginning in 2018-2025, you cannot deduct an excess business loss in the current year. An excess business loss means the amount of a loss in excess of $250,000, or $500,000 if you are a married joint-filer. The excess business loss is carried over to the following tax year, and you can then deduct it under new rules for deducting net operating loss (NOL) carryforwards, explained below.

Key Point: This new loss disallowance rule applies *after* applying the passive activity loss (PAL) rules. So if the PAL rules disallow your business loss, you don't get to use the new loss disallowance rule.

For NOLs arising in tax years beginning in 2018 and beyond, the TCJA stipulates that you generally

cannot use an NOL carryover to shelter more than 80 percent of taxable income in the carryover year. Under prior law, you could generally use an NOL carryover to shelter up to 100 percent of your taxable income in the carryover year.

Another TCJA change stipulates that NOLs arising in tax years ending after 2017 generally cannot be carried back to an earlier tax year. You can carry such losses forward only. But you can carry them forward indefinitely. Under prior law, you could carry an NOL forward for no more than 20 years.

TCJA Changes to Your Tax-Free Supper Money

Here's how the TCJA applied its tax reform to your supper money meal allowances. Before tax reform, you deducted 100 percent of the supper money cost. Now, because of tax reform, your tax deduction for supper money is subject to a 50 percent cut for amounts paid during tax years 2018 through 2025.

The regulations allow supper money as an excludable fringe benefit when the benefit satisfies the following four conditions:

1. You provide the benefit only occasionally.
2. You pay no more than a reasonable amount.
3. The meal enables you or the employee to work overtime.
4. You do not calculate the benefit based on the number of hours worked. For example, a $20 allowance per hour of overtime is a no-no. You can't do that. The way to provide the benefit is to give a discretionary meal allowance, such as $56.

If the payment of supper money does not meet the four rules, it is taxable compensation to the recipient, and if that's an employee, the money is subject to withholding and payroll taxes.

Corporate owners and the self-employed qualify for the supper money allowance under the four rules explained above. The law does not discriminate. It makes supper money available to all who work in the business.

If you would like to discuss any of these tax savings tips, please feel free to contact us.