IRA rulings: A review of recent personal tax items of interest

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When Congress has no interest except to go home, tax news get stagnant. The courts and the various IRS rulings become the center of the tax professional's interest. So we have a few of them here. It is of some interest to point out that when the economy is bad, the IRS and the courts tend to lean over backward to give the taxpayers a break. When the economy improves, the government gets more aggressive. I am currently seeing the more aggressive attitude taking hold.

Self-employed vs. household employee

The use of nannies has become common in today's world. Some people use them for taking care of young children so the parents can work. Others use them for the old and for the handicapped. Many times these "companions" come from agencies that employ them; however, many also come from recommendations from trusted sources. It is these individuals who have attracted the interest of the IRS because they may not be contributing to Social Security. The IRS has generally allowed these individuals to consider themselves self-employed. They report their income and are allowed to deduct any expenses they may incur that are not reimbursed. In the IRS view, this is an area of unreported income, particularly for Social Security tax purposes.

The IRS now wants to question whether these people are truly self-employed, or if they are household employees whose tax should be paid by the person for whom the services are provided. The IRS personnel have been instructed to question whether the caretakers are under the control of the recipients.

This one is going to be tough. Most have regular hours. While they may have some latitude in when various activities occur, very often they are instructed in general on what activities should and should not be performed. This will be an interesting hot topic going forward.

Shared ownership of residence

Here is a victory for taxpayers. This involves people who are not married but are sharing ownership of a residence with a mortgage in excess of $1,000,000. By law, the interest deduction on the mortgage is limited to the amount of interest paid on the million dollars. Heretofore the IRS argued: one residence, one mortgage, one deduction; the interest on the first million to be split between the two unrelated parties. The Ninth Circuit court decided that the one million dollar limit was per tax return. Thus, two individuals can each deduct the interest on up to one million dollars of mortgage (though not more than the total interest paid). The IRS has just acquiesced.

One thing to remember in all this happiness is that the unrelated parties must be on the title (must be owners) to deduct either the mortgage interest or real estate taxes.

IRA rollovers

The third subject pertains to rollovers from an IRA. The easy way to roll over an IRA or qualified plan to another plan is to open a new plan and have the new trustees request the old trustees to electronically transfer the funds. There are reasons, however, why people don't do it that way. Some people don't trust that the transfer will ever happen. Others find this a way to temporarily borrow the funds. The rule is that a rollover must be competed in 60 days after withdrawal. The problem is that, if the funds arrive on day 61, the entire withdrawal is taxable, and if the individual is under age 59.5, there is a 10 percent penalty added.

Many taxpayers run this down to the wire. It is easy to withdraw the funds, not easy to pay it back — perhaps the cash someone expected doesn't materialize; perhaps they get really sick. The IRS has now made it possible to avoid the penalty in certain instances. The IRS has instituted a "self-certification" procedure to avoid the penalty for late rollover if the reason is due to certain circumstances. The IRS has provided an example of a letter to be submitted to the new administrator — not the IRS — stating the reason why the rollover was late. The administrator can then regard the rollover as made on time BUT has to notify the IRS of its acceptance of a late filing. The IRS can then audit the taxpayer and find out if the reason was legitimate. The taxpayer better have a copy of the letter handy, and the reason better be correct.

Chief reasons include: The new trustees didn't process the deposit on time or made a mistake; the check was lost in the mail or in process; the deposit was erroneously made to the wrong account; the taxpayer or a member of his family died or was ill; or the taxpayer was in jail. This is better than nothing!

Previously, the administrators showed no remorse in reporting late rollovers as withdrawals on the year-end 1099Rs. Now, the IRS will have to audit to find out if the excuse is not legitimate. How often will that happen? I guess we will have to wait and see.