◆ 2013 ◆
Volume 1, Issue 1

Tax News and Industry Updates

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CERTIFIED PUBLIC ACCOUNTANTS

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Theft Loss Deduction Allowed for Incomplete Home Remodel Job

Cross References

- *Urtis,* TC Memo 2013-66, March 5, 2013

The taxpayers entered into a contract with a home construction and remodeling company to demolish an existing portion of their home and construct an addition in its place. The contract price of $400,000 was to be paid in installments. During the remodeling project, the owner of the construction company began demanding payments ahead of the scheduled installment payments, claiming that he needed the payments early for construction-related reasons, such as payment of subcontractors or payment for supplies. He claimed that if he did not receive the payments early he would have to delay the project. The taxpayers were eager to have the project finished as soon as possible so they made the requested payments.

Although there was some progress being made, the owner of the construction company made false claims about the actual progress. For example, he showed the taxpayers portions of the wiring in the remodeled area under construction and claimed that the wiring portion of the project had been completed. In fact, the wiring had not been completed. Not being experts in construction, the taxpayers were unable to detect that the owner of the construction company was lying to them about some aspects of the construction which he claimed to have completed.

Construction was running behind schedule when on July 29, 2006, the owner of the construction company suddenly died at the age of 30. The taxpayers discovered that many of the subcontractors were not being paid and that the owner was involved in several other construction projects which were undergoing financial difficulty. The owner of the construction company had a drug problem, which may have contributed to his financial problems and subsequent death.

After trying to recover their loss through court action, it was learned that the owner had also stopped paying premiums on the construction company's insurance policy.

The taxpayers claimed a $188,070 theft loss deduction as a result of the funds paid to the construction company that the taxpayers determined had been improperly used for purposes other than their construction project. The IRS disallowed the deduction by claiming the loss was not a theft under state law. The taxpayers argued that the loss deduction was allowed because the owner of the construction company did in fact commit a crime under state law.

The Tax Court agreed with the taxpayers. The owner of the construction company knowingly induced the taxpayers to enter into the contract by using deception and misrepresentations. The contract provided that the construction company was required to give the taxpayers copies of its current insurance certificates evidencing

that the company was insured, and that the construction company was required to notify the taxpayers of any changes with regard to its insurance. However, shortly after entering into the contract and providing proof of insurance, the owner ceased paying the premiums on the insurance policy, causing the policy to lapse. The taxpayers were not notified that the policy had lapsed. Several months later, the owner of the construction company began making other false statements and representations to the taxpayers regarding work which had allegedly been completed on their home and his need for funds to be paid in a manner other than that specified in the contract so that construction could proceed.

The IRS argued that the owner's improper taking of the taxpayer's money was merely a failure to comply with the terms of the construction agreement. The court disagreed. The court said it is clear that by virtue of his criminal fraud, the owner induced the taxpayers to enter into a contract which allowed him to obtain significant funds from them. Nearly half of those funds (the amount claimed as a theft loss) were then improperly used for purposes other than construction on the taxpayer's home, which the court believed was a scheme to wrongfully obtain funds belonging to the taxpayers. The court ruled the taxpayers were the victims of theft and therefore entitled to a theft loss deduction under IRC section 165.

Family Support Payments Treated as Alimony

Cross References

- IRC §71
- *DeLong*, T.C. Memo 2013-70, March 11, 2013

Payments made to a spouse or former spouse that meet the requirements as alimony are deductible by the payor and taxable to the recipient. Payments that are treated as child support are not deductible by the payor and not taxable to the recipient. A recent court decision allowed a taxpayer to deduct the entire amount of family support payments even though some of the payments were intended to be for child support.

The taxpayer was a resident of California when he separated from his wife. The couple had two children who resided with their mother after the separation. While the divorce was pending, they entered into a temporary court order where the taxpayer was required to pay the wife $3,000 a month as family support until a trial for the divorce case was held. The court indicated in the order that the $3,000 per month family support payments were for both spousal support and child support. The court order did not allocate any specific portion of the family support payments as spousal support or child support. The taxpayer deducted the entire amount on his tax return as alimony. The IRS disallowed the deduction, claiming the family support payments did not qualify as alimony.

Under IRC section 71(b)(1), payments are treated as alimony if all the following are true.

- Payments are required by a divorce or separation instrument,
- The payor and recipient spouse do not file a joint return,
- Payment is in cash (check or money order—not property such as furniture, vehicles, real estate, etc.),
- Payment is not designated in the instrument as "not alimony,"
- Divorced and legally separated spouses are not members of the same household when payment is made,
- Payments are not required after death of the recipient spouse, and
- Payment is not treated as child support.

The IRS contended that the family support payments failed to satisfy the alimony test because the payment was designated as "not alimony," and the taxpayer's requirement to make the payments would have continued past the death of the recipient spouse.

The court said the temporary court order did not expressly state that the taxpayer's requirement for making the family support payments would terminate on the death of his spouse. Under California law, spousal support obligations terminate upon the death of the payee spouse, while child support obligations survive the death of the payee spouse. However, the law does not say whether a family support obligation terminates upon the death of the payee spouse. The court has ruled in other tax court cases that California family support obligations do not continue past the death of the payee spouse. Therefore, the court ruled that the taxpayer had no continuing liability for the family support payments past the death of the spouse.

The IRS also argued that the family support payments were designated as "not alimony" because the support order indicates the family support payments were partly for child support. The court said that child support is defined as any part of a payment that the terms of a divorce or separation instrument specifically fix as a sum that is payable for the support of the payor spouse's children. The court said the term "fixed" is generally taken literally and child support cannot be inferred from intent, surrounding circumstances, or other subjective criteria. An amount fixed as payable for child support includes any amount specified in the instrument if that amount will be reduced on the happening

of a contingency specified in the instrument relating to a child, such as attaining a specified age, marrying, dying, leaving school, etc., or at a time that can clearly be associated with such a contingency.

In this case, the support order made an unallocated award of spousal and child support. Consequently, it does not fix any portion of the family support payments as a sum that is payable as child support. Additionally, there is no amount specified in the support order that was to be reduced upon the occurrence of a contingency relating to the children.

Accordingly, the court ruled that no amount of the family support payments qualified as child support under IRC section 71(c) and, therefore, all the payments were deductible by the taxpayer as alimony.

HSA Inflation Adjusted Amounts

Cross References

- IRC §223
- Rev. Proc. 2013-25
- Rev. Proc. 2012-26
- Rev. Proc. 2011-32

The IRS announced inflation adjusted amounts for health savings accounts (HSAs) for 2014. These amounts are reflected in the chart below.

HSA Limitations:

Annual contribution is limited to:	*2014*	*2013*	*2012*
Self-only coverage, under age 55	$3,300	$3,250	$3,100
Self-only coverage, age 55 or older	$4,300	$4,250	$4,100
Family coverage, under age 55	$6,550	$6,450	$6,250
* Family coverage, age 55 or older	$7,550	$7,450	$7,250
Minimum annual deductibles:			
Self-only coverage	$1,250	$1,250	$1,200
Family coverage	$2,500	$2,500	$2,400
Maximum annual deductible and out-of-pocket expense limits:			
Self-only coverage	$6,350	$6,250	$6,050
Family coverage	$12,700	$12,500	$12,100

* Assumes only one spouse has an HSA. See IRS Pub. 969 if both spouses have separate HSAs.

Employer-Provided Vehicles

Cross References

- Notice 2013-27

If an employer provides an employee with a company-owned vehicle, and the employee uses the vehicle for personal purposes, then the value of that personal use must be included as taxable income on the employee's W-2. Under the general rule, the taxable amount equals the FMV of the total use, minus the amount the employee pays for the use, minus the amount excluded from income as a working condition fringe benefit. [Reg. §1.61-21(b)]

Cents-per-mile method. There are several methods allowed by the IRS to value the vehicle rather than using actual costs. One method is the cents-per-mile valuation method. Under this method, the taxable use is determined by multiplying the employee's personal miles by the current standard mileage rate. The standard mileage rate includes the cost of fuel. If the employee pays for the cost of fuel, the cents-per-mile rate can be reduced by up to 5.5¢ per mile. An employer can calculate the personal use value of a vehicle under this method if all of the following are true.

- The employer reasonably expects the vehicle will be used on a regular basis in the employer's trade or business. Regular use is determined under all facts and circumstances. The vehicle is considered regularly used if at least 50% of the vehicle's total annual mileage is for business, or the vehicle is used each workday to transport at least three employees to and from work in an employer-sponsored commuting vehicle pool.
- The vehicle is driven at least 10,000 miles per year and the vehicle is primarily used by the employee.
- The FMV of the vehicle at the time it is first made available to the employee for personal use does not exceed the luxury vehicle limits of Section 280F.

New limits for 2013. There are two separate Section 280F limits for passenger autos and trucks or vans first used by the employee in 2013. The limits are:

- $16,000 for a passenger automobile.
- $17,000 for a truck or van. (Notice 2013-27)