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Salvage Write-Offs on Home Equity Loans
Deduct mortgage interest for home improvements

Are you planning to take out a home equity loan to pay for home improvements? Unfortunately, the Tax Cuts and Jobs Act (TCJA) cracks down on mortgage interest deductions for home equity loans, among other changes. However, if you play your cards right, you may have an ace in the hole.

How it works: Due to the way the IRS interprets the law, you can still deduct mortgage interest deductions on home equity loans when the proceeds are used for home improvements (IR-2018-32, 2/21/18). It all has to do with the tax law distinction between loans treated as "acquisition debt" and those that are characterized as "home equity debt."

The basic rules are as follows: Generally, you can deduct mortgage interest you pay during the year if you itemize deductions. To qualify, you must be legally obligated to pay the mortgage secured by a **qualified residence**. For this purpose, a qualified residence may be your principal residence and one other home, such as a vacation home.

The deduction depends on whether the debt is an acquisition debt or a home equity debt.

1. Acquisition debt: This is a debt incurred to "buy, build or substantially improve" a qualified home. Prior to the TCJA, mortgage interest paid on up to $1 million of acquisition debt was fully deductible.

2. Home equity debt: Any other qualified debt, such as a home equity loan or line of credit, is treated as home equity debt. Previously, mortgage interest paid on up to $100,000 of home equity debt was deductible, regardless of how the proceeds were used. In other words, you could deduct the interest even if you used the money to take a vacation or buy a new car.

But the TCJA changed the lay of the land. For acquisition debt, the threshold is reduced from $1 million to $750,000 for 2018 through 2025. This new limit generally applies to debts incurred after December 15, 2017. (Deductions for existing acquisition debts are grandfathered even if they are subsequently refinanced up to the remaining amount of debt.)

Even worse, the deduction for interest on home equity debt is completely eliminated for interest paid in 2018 through 2025. This is a problem for many borrowers.

Key point: If you take out a new home equity loan or line of credit and use the proceeds for home improvements like a finished basement or deck, the debt is treated as acquisition debt instead of home equity debt. It qualifies as a debt incurred to "substantially improve" a qualified residence. Therefore, the interest is deductible as long

as the total amount of the debt doesn't exceed the original purchase price and you stay below the new $750,000 threshold for acquisition debt.

In fact, just a small **money management** change can salvage a deduction. For instance, if you were planning to use bank account funds for a home improvement and take out a home equity loan to help pay for some of your child's college expenses, you might switch the use of the funds. As a result, you can convert a nondeductible interest expense into deductible interest.

Note: Special rules apply to home equity loans in certain states like Texas. Consult with your tax advisor for your situation.

Safeguarding Your Computer Network
Take steps to improve security measures

Would you ask a salesperson to hold onto your wallet or pocketbook while you go shopping in their store? Of course not. Yet, in effect, some small business owners are doing virtually the same thing with their computer network when they conduct business online. It is almost like you are giving hackers a license to steal your money or information.

What are the potential dangers? There are several ways outsiders may be able to gain access to a company's network. One possibility is to use a password-guessing program that seeks and identifies IP addresses. Another type of program allows users to scan multiple host computers for vulnerabilities. Also, be aware that hacking may occur from **"inside" sources** like your own employees or others who have access to the business premises or your computer network.

What's more, some sophisticated computer programs that were originally designed as theft deterrents may be used for illicit means. In many cases, the hackers are more innovative than the creators. And that is bad news for business owners.

So can you stop online thieves in their tracks or, at the very least, slow them down? Consider implementing the following **safety measures** as part of a comprehensive security program:

- Maintain physical security. Is it possible for someone to walk up to your network and shut the entire system down with one flip of a switch? The network server should be kept in an area that is off-limits to most personnel. You might even install security software that limits access to the keyboard and screen.

- Install a **firewall**. A firewall simply separates the Internet from your company's computer network. In effect, it screens or blocks outside intrusions that look suspicious. Firewalls can also be used to partition one department of your company from another.

- Review your list of network users. Make sure that **passwords** are changed on a regular basis. Instruct your employees to use nonsensical passwords (or have them use a password generator) rather than common words or family names. In addition, supervisory privileges should be limited to a select group of high-ranking employees or officers. Is file sharing too rampant? This may give outsiders easy access to sensitive data.

- Seek protection against **computer viruses**. The most common method is to acquire software that can help protect you against the type of viruses that could infect your network. Keep up-to-date with the latest updates. Also, keep an eye out for new innovations and improvements.

Naturally, there are no guarantees that the precautions will provide the security you need in all cases. At a minimum, however, taking these steps can result in a good first line of defense. If you don't have the necessary expertise to address these issues yourself, assign the job to someone in your firm or a third party who can handle the responsibilities.

Count on a Cutting-Edge Tax Break
How to qualify for the research credit

The Tax Cuts and Jobs Act (TCJA) created some new tax breaks for businesses while taking certain others away. But the TCJA did not touch the research credit for qualified expenses. What's more, under another recent law, the Protecting Americans from Tax Hikes (PATH) Act, the benefits have been enhanced.

Background: The research credit is generally equal to 20% of the amount of qualified research expenses for the year exceeding a base amount. The base amount is a fixed-base percentage (not to exceed 16%) of average annual receipts for the prior four years. In no case, however, can it amount to less than 50% of the annual qualified research expenses.

Alternatively, a business can elect to use a **simplified credit** based on 14% of the amount by which qualified expenses exceed 50% of the average qualified expenses for the three previous tax years.

However, the research credit is not automatic. The following three requirements must be met to claim the credit.

- The expense must qualify as a "research and experimentation expenditure" under **Section 174** of the tax code. Such expenses include in-house wages and supplies attributable to qualified research; certain time-sharing costs for computer use in qualified research; and 65% of contract research expenses (i.e., amounts paid to outside contractors in the U.S. for conducting qualified research).

- The expense must relate to research undertaken for the purpose of discovering information that is technological in nature and the application of which is intended to be useful in developing a new or improved business component.

- Substantially all of the activities of the research constitute elements of a process of experimentation that relates to a new or improved function, performance, reliability or quality.

Note that the same or similar expenses may qualify for a research and experimentation deduction under Section 174. However, any Section 174 deduction must be reduced accordingly if you claim the research credit for the same expenses.

As with other “tax extender” provisions, the research credit has expired and been extended numerous times in the past. But the PATH Act brought it back to life for 2015 and thereafter. The credit is now a permanent part of the tax code.

Finally, the PATH Act also enhances the research credit for certain companies for tax years beginning after 2015. Notably, a **start-up company** may annually claim up to $250,000 of the credit against its FICA tax liability for up to five years. To qualify, the company must have less than $5 million in gross receipts for the year. Another change in the PATH Act protected some companies from the corporate alternative minimum tax (AMT). This is now a moot point since the TCJA repealed the corporate AMT.

In summary: The research credit is an important tax incentive for businesses of all sizes. Coordinate your efforts to maximize the tax benefits that may be claimed under current law. Your tax advisers can provide the assistance required in this area.

Five Tips for Better Work Relationships
Coping with difficult people on the job

If you have a long career, you will likely be forced to deal with “difficult” people on some level. It may be a co-worker, a client, a vendor or supplier, or a supervisor. This can make you dread coming to work everyday and affect productivity and performance.

Practical advice: Do not despair. There are steps you might be able to take concerning a person or people you cannot tolerate. It can benefit you and the company overall. Here are five ideas to consider.

1. Face down the office bully. A bully may intimidate you, insult you in front of others or otherwise make your life miserable. But you do not have to simply accept it. For instance:

- Set limits on what you will tolerate. There is a line in normal workplace behavior that should not be crossed. If the bully does, be prepared to act in a reasonable manner.

- Confront the bully. Point out the inappropriate behavior. Surprisingly, the bully may not be aware of the effect he or she is having.

- Document incidents. Make sure you have proof of a bully's actions in case either one of you is called on the carpet.

- Follow the rules. It is likely that your human resources (HR) department has established procedures. Consult with HR to determine how to best proceed.

2. Be a team player. In most cases, a successful business depends on cooperation among employees. Rather than working for just yourself, work with others, no matter how difficult they can be. Be aware of issues that deserve some leeway. Do not sink to the level of bullies or disruptive co-workers; rise above it.

3. Tackle annoying habits. Frequently, someone you work with, including an employee under your supervision, may exhibit annoying or disgusting traits. It could be anything from offensive body odor or breath to constantly clicking pens or drumming desks in meetings. As with confronting bullies, initiating conversation about this requires courage. Be sensitive to the other person's feelings, but do not beat around the bush, either. Honesty is usually the best policy.

4. Cut down the gossip. Unfortunately, gossiping is rampant at many workplaces. Despite appearing to be harmless on the surface, it could result in low morale and a toxic corporate culture. If you are a company manager or owner, you should not turn a blind eye to these goings-on. Address problems head-on and institute policies that deter the most troubling aspects.

5. Diffuse negative vibes. Last, but not least, is your company hounded by "Negative Nellies" who never, or rarely, have anything good to say? Before you do anything, listen to their complaints. If they are legitimate, consider making improvements. However, if they are not, do not allow the negativity to fester. It might require discipline, warnings and, in the worst-case scenario, a change in employment.

Do not simply ignore these problems and hope they will go away. It is most likely they will not and could get worse. Find the solutions that will work for you and your company.

New Ruling on SALT Refunds

Under the Tax Cuts and Jobs Act (TCJA), the deduction for state and local taxes (SALT) is limited to $10,000 annually for 2018 through 2025. This new limit raises other tax

issues. For instance, a long-standing tax rule says that state and local income tax refunds are taxable in the year received to the extent that the recipient receives a **tax benefit**.

A new IRS ruling clarifies the tax treatment for refunds affected by the TCJA (Rev. Rul. 2019-11, 3/29/19). It provides examples showing that taxpayers who are subject to the new SALT limit may not have to report tax on the **full refund**. Consult with your tax advisor concerning your situation.

Facts and Figures
Timely points of particular interest

Expense Accounting—According to a new survey, some expense reporting is raising eyebrows at finance departments across the country. The research shows that 56% of CFOs have cited an increase in the number of **improper reimbursement** submissions during the last three years. Some of the most eye-catching infractions included requests involving a cow, Super Bowl tickets and invoices for another company.

Child Tax Credits—If you are a parent, you may be able to claim the Child Tax Credit (CTC) for offspring up to age 17. Under current law, the CTC is $2,000, of which up to $1,400 is refundable. It is also subject to a phase-out at certain income levels. But the child must have a **Social Security number** (SSN). There are no exceptions this rule—the IRS says you can't even avoid the SSN requirement based on religious grounds.