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2016 Tax Return Preparation Reminders

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It's that time of year again when folks are sorting out (or maybe just starting to sort out) their tax return filing obligations for 2016. As this is done, consider whether any of the following apply to you – this tax season I've been seeing and advising on these topics frequently.

- Limitations on the deductibility of pass-through losses on your personal income tax return. If you are an owner of an LLC (or partnership) whose Schedule K-1 shows a pass-through loss, remember to what extent you can take that loss on your personal tax return. It is limited by rules relating to *basis*, *at-risk*, and *passive* activities. First, losses are deductible only to the extent of your basis in your ownership interest, which increases by the amount of capital you put in and income allocated to you and decreases by distributions received and losses allocated to you. Tracking your basis is your responsibility, not the LLC's. Next, the at-risk rules generally limit your loss to the amount of your investment you could actually lose. For example, you're not typically at-risk for LLC nonrecourse debt or other borrowings used in the LLC protected against loss (all of which, however, could provide you basis). Finally, if you don't materially participate in the LLC, losses are then considered passive and can be used to offset only other passive income, not active income. There are extensive rules for determining whether someone is materially participating in an activity. If your pass-through losses are limited by any of these rules, such losses are generally carried forward to future years in which you may be able to take them.

- Potential deductibility of payments to governmental agencies. A business expense you'd typically consider deductible is not if it's a fine or penalty paid to the government for the violation of any law (federal, state, or local). This includes any payment in settlement of an actual or potential liability for a fine or penalty, although deductibility is not barred for a payment of compensatory damages – in other words, only punitive payments are not deductible. To garner additional clarity as to deductibility of payments to governmental agencies, one must further evaluate nuanced case law and internal IRS guidance.

- Upcoming deadline for filing FBAR. In 2016, focus on global tax transparency – namely hidden assets and unreported earnings – has not waned. If anything, it has intensified. To that end, one long-standing requirement with potentially broad applicability, although with seemingly ever-changing rules, is the annual reporting to the U.S. of foreign financial accounts. This report is known as the FBAR, which for 2016 is due April 18, 2017 and must be filed electronically.

  The rules are cumbersome with many exceptions. Some guidance can be found at https://www.irs.gov/businesses/small-businesses-self-employed/report-of-foreign-bank-and-financial-accounts-fbar.

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