JOHNDFAUCHER.COM, ISSUE NO. 12 SPRING 2017

The Newsletter
Faucher Law

Forgiven Loans, Property Sales, Bankrupt S Corporations

3 Reasons IRS Rules Seem Unfair

Cancelled Debt is Income. Many loans, when forgiven by the lender, fall under Tax Code Section 108: the amount of the loan forgiven is reported as income to you, in the year the debt was forgiven. This occurs when loans are renegotiated (for instance, the borrower pays only 50 percent of what's owed) or when credit card debt is forgiven (exceptions to Section 108 involve bankruptcy, insolvency and home foreclosure). Most of my clients are outraged when they owe taxes on, for example, a credit card balance that was written off – after all, this wasn't income, in that they didn't go to work to earn this. However, to the IRS it *was* income because it was a transfer of wealth to you: You purchased items that you won't pay for.

5 LEAST LOVED U.S. TAXES

1) Tax on Minimum Retirement Account Distributions (as of age 70.5): mandatory distributions (even if not needed) from retirement accounts trigger income tax.
2) Alternative Minimum Tax: complex, confusing and disallows many deductions.
3) Taxing Social Security Benefits: hit with the tax all your life, when you finally get social security payments, you're taxed again (unless you have very little income)!
4) Social Security/Self-Employment Tax (6.2% to employed, 14.4% to self-employed, and many people don't think they'll actually receive benefits upon retirement).
5) Estate Tax (parents' income was taxed during their lives, now it's taxed again when they pass on too much of it to kids?).

Source: 2015 Fiscal Times

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Selling Refinanced Property. A client sold a rental property after owning it for decades. He'd borrowed against the building's significant appreciation with many refinances over the years. When he sold the building, my client owed capital gains tax (the difference between the original price at which the building was purchased and what it sold for, minus verifiable capital improvements). However, the building had so many refinanced mortgages that were repaid with the sales proceeds, that there was no cash left with which to pay the huge tax bill. My client complained, "It's unfair! I didn't even get any money out of the sale!" But he did – in the form of all those refi proceeds he pocketed over the years. This isn't so much unfair as it is predictable, if the client had remembered the tax consequences of selling a highly-leveraged property. The time to come to me is often not after the problem has occurred, but whenever big financial transactions are considered.

FAVORITE TAXES

Source: John Faucher's best guess

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Bankrupt S Corporation. A client owned an S corporation, an entity whose income passes through to owners regardless of how much money the corporation distributes to them. The corporation filed for bankruptcy, a trustee took it over, and it continued to operate. At the end of the year, it filed a tax return reporting income, but an S corporation pays no tax. The owner, who was not in bankruptcy, had to report the income on his individual return, while the bankruptcy trustee operated the business, using its income to pay creditors, rather than make distributions to owners. Talk about unfair! Well, not as the IRS sees it: the corporation borrowed money and benefited from loans without reporting them as income in the past. It had a legal obligation to repay loans, which the trustee upheld. The owner, stuck with the tax bill on the unpaid loans, was made responsible for the poor management decisions that did not turn those loans' proceeds into a financially viable business. **JDF**

WELCOME TO FAUCHER LAW

John D. Faucher worked for 10 years as an IRS trial attorney, and has been in private practice since 2008. He and his team speak the legal language. They know the **tax and bankruptcy** systems and can help you get the best results. Have other legal issues? Call us. We'll find the lawyer who's right for you, your friends or family.

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Fairness? IRS Can Be Taxing

April 15 has come and gone again but the deadline for late tax filers is coming up in October. No wonder the Internal Revenue Service's peculiarities are so often on my mind. A lot of us think there's something unfair about the federal tax code: the alternative minimum tax, the 10 percent threshold for medical expense deductions, and so on.

So, in this issue of The Newsletter, I focus on three little-known tax-traps, all of which seem horribly unfair to my clients but for which the IRS has an explanation. After all, why *not* get more riled up than we already are about the IRS – or about those in Congress who wrote the tax laws?

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