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Tax-Saving Tips

January 2026

Should You Skip Home-Office Depreciation to Dodge Recapture?

Introduction

Many taxpayers panic when they hear the term "depreciation recapture" and decide to skip depreciation on a home office to avoid future tax. That strategy usually backfires. The tax law creates unexpected consequences when you claim zero depreciation, and those consequences often cost more than the recapture tax you tried to avoid.

When you skip depreciation, the IRS applies the allowed-versus-allowable rule. The depreciation you claimed counts as the "allowed" amount. The depreciation you should have claimed counts as the "allowable" amount. If you claimed zero depreciation but should have claimed $5,000, the tax law treats those amounts as different. That difference creates two problems.

First, you lose real tax deductions today. By skipping $5,000 of depreciation, you voluntarily increase your current tax bill.

Second, the tax law still treats the $5,000 as depreciation when calculating your gain on sale. That $5,000 reduces your basis in the home, which can increase your taxable gain later.

In the wrong situation, you pay tax twice: once by losing the deduction and again through a higher gain.

The good news is that your prior tax returns protect you from depreciation recapture if you claimed zero depreciation. Section 1250(b)(3) allows you to use the amount actually claimed when calculating recapture. Your home-office deduction Forms 8829, which show zero depreciation, serve as adequate records. As a result, you avoid the unrecaptured Section 1250 gain tax on depreciation you never claimed. But the law does not extend that same relief when you compute gain on sale. For taxable gain purposes, the IRS requires you to reduce your basis by the allowable depreciation, even if you never claimed it. That rule can push your gain above the Section 121 home-sale exclusion and trigger capital gains tax.

Despite this complexity, skipping depreciation rarely makes sense. Depreciation delivers immediate tax savings and valuable cash-flow benefits. The recapture rate often runs lower than your current income tax rate. You can also defer recapture through a Section 1031 exchange or eliminate it entirely with a step-up in basis at death.

The bottom line remains simple: Do not skip home-office depreciation. Claim the deduction, use the tax savings now, and plan intelligently for the future.

When Work Clothing Is Deductible

Taxpayers often assume that clothing purchased for work qualifies as a tax deduction. The tax law takes a much narrower view. As a general rule, the IRS does not allow a deduction for work clothing if it serves as everyday streetwear. This rule applies even when a taxpayer buys the clothing solely for work and never wears it outside the job.

Business suits, skirts, dresses, and other professional attire do not qualify for a deduction. Casual work clothing, such as khaki pants, plain shirts, or everyday boots and shoes, also fails the test. The IRS never allows a deduction for watches, regardless of business use. The law allows deductions only for clothing that clearly does not function as everyday wear.

Required uniforms that identify an employer and lack personal utility qualify for a deduction. Airline pilot uniforms, professional sports uniforms, and required nursing uniforms meet this standard. Protective gear required for safety also qualifies. Electricians may deduct safety shoes that protect against electrical hazards, and truck drivers may deduct insulated coveralls, steel-toed boots, gloves, and safety glasses used exclusively for long-haul work.

Specialized apparel also qualifies when it serves a specific job function and does not adapt to personal use. Hospital scrubs, grease-stained mechanic overalls, and custom performance costumes fall into this category. Promotional clothing may qualify as well when the employer requires it, marks it with a logo, and restricts it to business use. When clothing qualifies for a deduction, related laundry and dry-cleaning costs qualify too.

Independent contractors may deduct qualifying work clothing on Schedule C as an ordinary and necessary business expense, provided they keep proper records.

Employees face a different rule. The tax law permanently eliminated deductions for employee work clothing. Employees should instead seek reimbursement from their employer. When an employer reimburses these costs under an accountable plan, the employee receives the payment tax-free, and the employer claims the deduction.

Avoid This Hidden Tax Trap in Mileage-Reimbursed Vehicles

If you receive mileage reimbursements from your employer or your corporation, you may face an unexpected tax result when you sell or trade your vehicle. Many employees assume that mileage reimbursements end the tax story. That assumption often leads taxpayers to miss a valuable deduction—or to get blindsided by a taxable gain.

When your employer reimburses you at the IRS standard mileage rate under an accountable plan, the tax law treats your personal vehicle as a business vehicle. The standard mileage rate includes a built-in depreciation component. Each reimbursed mile reduces your vehicle's tax basis, even though you never claim depreciation on your return and never include the reimbursements in income. This basis reduction matters when you dispose of the vehicle.

Consider Leo, a W-2 employee who bought an $85,000 car and used it 100 percent for business. Over four years, his employer reimbursed him $33,304 for business miles. Those reimbursements felt like full payback. But embedded in those payments was $14,815 of deemed depreciation, which reduced Leo's basis in the vehicle to $70,185. When Leo traded the car for $47,000, the tax law treated that trade as a taxable disposition. Because vehicle trade-ins no longer qualify for like-kind exchange treatment, Section 1001 required Leo to compare his trade-in value to his adjusted basis. The result surprised him—in a good way. Leo realized a $23,185 loss.

Because the vehicle qualified as depreciable business property held for more than one year, Section 1231 turned that loss into an ordinary deduction. Leo reported the transaction on Form 4797 and deducted the loss against ordinary income, even though his employer reimbursed every business mile he drove.

This result often surprises employees and corporate owner-employees. Mileage reimbursements cover current operating costs and a portion of wear and tear, but they do not recover your full investment in the vehicle. When you sell or trade a mileage-reimbursed car for less than its remaining basis, the tax code allows you to deduct the unrecovered amount.

Commissions Assigned as S Corporation Management Fees, Exposed

We continue to see aggressive advice circulating about routing personal commissions through an S corporation to reduce self-employment tax. This strategy sounds attractive, but it fails under long-standing tax law and creates significant audit risk.

Consider a common setup: An individual earns commissions under contracts issued in his personal name. He holds the required state license individually, and payors issue Forms 1099-NEC to his Social Security number.

Despite these facts, he attempts to shift the income into an S corporation by charging a "management fee" equal to most or all of the commissions, or by directing payors to deposit the commissions directly into the S corporation's bank account. Neither approach works.

Tax law focuses on one central question: Who earned the income? When income arises from personal services, the individual who performs the services and controls the earning of that income must report it. Labels, internal invoices, and bank routing do not change that result.

A 100 percent management-fee approach collapses quickly under scrutiny. The IRS compares the 1099s issued to the individual with the tax return and sees commissions wiped out by a related-party fee. Examiners routinely reclassify the commissions as the individual's Schedule C income, deny the fee, and unwind the S corporation reporting. The result places the income back where it started—subject to self-employment tax—along with interest and penalties.

Routing commissions by ACH directly into the S corporation's account fares no better. The contracts remain in the individual's name. Licensing records still identify the individual. The 1099s still list the individual as payee. The IRS simply treats the deposits as income constructively received by the individual and then transferred to the corporation. This tactic often worsens the audit narrative by suggesting intentional income shifting.

A management fee can work only when the S corporation performs real, measurable services and charges a reasonable, supportable fee for those services. The fee must compensate administration, staffing, marketing, and/or infrastructure—not attempt to transfer ownership of the commissions themselves.

Effective S corporation planning requires the corporation to sit legitimately in the income stream, with contracts, regulatory approval, and reporting aligned to that structure. Anything else invites predictable adjustments.

Why Serious Landlords Rely on the 1031 Exchange

Serious real estate investors rely on the Section 1031 exchange because it allows them to grow wealth faster while legally deferring federal income taxes. When you sell rental property without using a 1031 exchange, capital gains tax and depreciation recapture immediately reduce the cash you can reinvest. A properly structured exchange keeps all sale proceeds working for you.

With a 1031 exchange, you can sell appreciated rental property, reinvest every dollar, and move into larger or higher-performing assets. Many landlords use exchanges to trade single-family rentals for multifamily properties, consolidate management, and increase cash flow. You can repeat this process over decades without triggering federal tax.

Consider a simple illustration: An investor buys a rental for $100,000, sells it years later for $175,000, and reinvests the proceeds through a 1031 exchange. He repeats that process multiple times and builds a portfolio worth $10 million. During his lifetime, he pays no federal income tax on any of those sales.

At death, his heirs inherit the properties with a step-up in basis to fair market value, which eliminates the deferred tax entirely.

To start a successful exchange, you must engage a qualified intermediary before you close on any sale. The intermediary holds the proceeds and guides you through the required steps. You should select this firm carefully and involve your tax advisor early.

Most investors use a forward 1031 exchange. In this structure, you sell your existing rental first and then purchase a replacement property. You must identify replacement properties within 45 days and complete the purchase within 180 days. The process is straightforward and relatively inexpensive, but missed deadlines will destroy the exchange.

Some investors choose a reverse 1031 exchange when they need to buy first. In that case, the intermediary parks the new property in a temporary entity while you sell your existing rental. This approach costs more and requires additional planning, but it solves timing and inventory problems.

The 1031 exchange remains one of the strongest tools for long-term real estate growth. With careful planning, strict attention to deadlines, and the right intermediary, you can defer taxes indefinitely and pass substantial wealth to the next generation.