TaxTips

Dedicated to making your life less taxing

Winter 2019-2020

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Cyber Security

How to protect your business

For organizations of every size and type, data security is an essential aspect of IT. Hackers are constantly finding ways into our data, which requires constant vigilance by business owners. Being proactive is the key to protecting yourself and your business from data theft.

Start by creating a data security plan. This may entail working with outside service providers and designating one or more employees to coordinate the program. The program should be flexible since circumstances and risks to customer information is extremely fluid. A stable plan starts with performing background and screening checks on potential employees during the hiring process.

Thieves will send emails pretending to be from existing customers, a potential client, financial institutions, etc. Create an educational program for all employees so they understand the dangers of phishing emails, opening links or attachments from suspicious email addresses, or answering phone calls from unrecognized numbers. Be sure to purchase top-notch security software that includes a firewall and anti-malware/anti-virus security software. Use this type of software on all devices including laptops, desktops, tablets, smartphones, routers, etc.

Adopt strong password protection. Passwords should be a minimum of 10 characters and use a combination of letters, numbers and symbols. Passwords should also omit personal information and should not be reused. Always use unique usernames and passwords for all accounts and devices. For extra security, consider implementing a multifactor authentication process.

Encrypt all sensitive files and emails. Encrypted files should require a password to open. Make it a priority to back up pertinent information and store any external drives in a secure location. In addition, limit access to pertinent business or customer data to only employees who need to know.

Remember an ounce of prevention is worth a pound of cure when dealing with cybercrime.

Solar panels are hot

For a tax credit

The residential energy efficient property credit has been reinstated through 2021. This means you could get a tax credit for installing solar panels on your home. You can even get a credit if you shared the cost of solar panels not directly located on your home, such as at an off-site community solar array or similar arrangement that generates solar energy directly for your home. The credit is equal to 30% of the cost of qualified solar electric property made prior to December 31, 2019, 26% for expenditures made in 2020 and 22% for expenditures made in 2021. There are some limitations on the credit. Additionally, unused credit amounts may be carried to future tax years.

As with any tax law, there are many variables that come into play for this credit. If you are thinking about making energy efficient improvements, let’s get together and make improvements not only for our planet but for your taxes as well!

Safe Harbor for Rental Properties

Getting a qualified business income deduction

Landlords who spend at least 250 hours a year managing and maintaining their rental properties may be eligible for the Qualified Business Income (QBI) deduction. That averages out to just under five hours a week.

Unlike other deductions, the qualified business income deduction does not require that you spend money. Instead, it's a straight deduction, for up to 20% of net rental income for the year. For clients who qualify, this deduction allows rental property owners to pay tax on as little as 80% of their net income from qualifying rental properties. We even have the option of grouping several rental properties together to meet the 250-hour requirement.

Qualifying for this deduction can be tough. Here are the three factors we're looking for:

- 250 hours per year spent managing and maintaining your rental properties.
- You did not live in the rental property for any part of the year.
- The property isn't rented under a triple-net lease.

To reach the 250-hour threshold for the QBI deduction, we add up the hours you spend managing the rental property, and also time spent by your property manager, landscapers, repair contractors, and any other people you hire to maintain or manage the rental properties. Rental services that count toward the 250-hour test include:

- Advertising
- Negotiating leases
- Verifying rental applications from prospective tenants
- Collecting rents
- Maintenance and repairs
- Purchasing materials
- Supervising contractors and employees

Keep meticulous records of all the time spent managing your rental properties. Reviewing your time logs is how we—and the IRS—will be able to figure out if you qualify for the QBI deduction for the year.

You'll need to keep track not only of the time you spent yourself, but also time spent by any other people you hire to work on your rental properties. Your time log will need to track four data points:

- The dates rental property services were performed
- Number of hours spent
- Who performed the work
- A description of all the work done on that day

Finally, the IRS requires that you maintain separate books and records for each rental property. We can help you set up your bookkeeping, records and time logs so that you can claim this valuable deduction.

Charitable Contributions

Donate via your IRA

With the larger standard deduction amounts beginning this year, many people could lose the tax benefit of making charitable contributions. To reduce tax liability, certain taxpayers could use a qualified charitable distribution (QCD).

A QCD allows anyone age 70½ or older to donate up to $100,000 annually from their IRA account directly to one or more charitable organizations without the distribution counting as income. In addition, if a spouse qualifies, he or she could also make another QCD up to $100,000 from his or her own IRA. It's imperative that the distribution goes directly to the charity and not to the taxpayer; otherwise, it will be taxable.

The charity must be a §501(c)(3) organization eligible to receive tax-deductible contributions. Private foundations, supporting organizations and donor-advised funds do not qualify. Also, when making a QCD, you must receive the same type of acknowledgment of the donation that you would need to claim a deduction for a charitable contribution. However, since a QCD is not taxable, it is not deductible as a charitable contribution.

Any money you transfer to charity in this manner will reduce the amount you must take in required distributions for the year. The best part is that this charitable giving strategy will reduce your AGI, which could, in turn, lower the amount of any Social Security income subject to income tax! The QCD could also decrease the amount of your Medicare premiums for the following year.

Since Roth IRAs do not require minimum distributions during your lifetime, and their distributions are generally tax-free, it is generally not advisable to make a QCD from a Roth IRA.

Currently, your IRA custodian is not required to specifically identify the QCD on your annual Form 1099-R. Make sure you inform me if you take advantage of this tax saving strategy to ensure it is properly reported on your tax return.

Divorce-Related Tax Issues for Small-Business Owners

As with all financial transactions, divorce comes with tax consequences. And those consequences have changed for tax years 2018 and later thanks to the Tax Cuts and Jobs Act (TCJA).

General Rule

The general tax rule in a divorce is that you can divide up most assets, including cash, between you and your soon-to-be ex-spouse without any federal income or gift tax consequences.

When an asset falls under the tax-free transfer rule, the ex-spouse who receives the asset takes over its existing tax basis (for tax gain/loss purposes) and its existing holding period (for short- or long-term holding period purposes).

Example. Your divorce settlement calls for your soon-to-be-ex to get 40 percent of your highly appreciated small-business corporation stock. Thanks to the tax-free transfer rule, there's no impact when you transfer the shares.

Your ex keeps on rolling under the same tax rules that would have applied had you continued to own the shares (carryover basis and carryover holding period). When your ex ultimately sells the shares, he or she (not you) will owe any resulting capital gains taxes.

QDRO Required

Does your business have a qualified retirement plan, such as a profit-sharing plan, 401(k) plan, or defined benefit pension plan? If so, you probably will be required to give your soon-to-be-ex a percentage of your account balance or benefits as part of the divorce property settlement.

The trick is to do this without putting yourself on the hook for income taxes on amounts that go to your ex. Here's the drill: include a qualified domestic relations order (QDRO) in the divorce papers. The QDRO makes your ex responsible for the income taxes on retirement account money that he or she receives in the form of account withdrawals, a pension, or an annuity.

In other words, the QDRO causes the tax bill to follow the money, which is only fair.

QDRO Not Required

You don't need a QDRO to obtain an equitable tax outcome when you are required to turn over some of your IRA money to your ex as part of a divorce property settlement. QDROs are only relevant in the context of qualified retirement plans.

Therefore, you don't need a QDRO for your Simplified Employee Pension accounts, Savings Incentive Match Plan for Employees (SIMPLE) IRAs, traditional IRAs, and Roth IRAs. Even so, you have to be careful and use the magic words to avoid getting taxed on money that goes to your ex.

Magic Words

Avoid the tax problem: include magic words in the divorce papers.

You can make a tax-free transfer of all or a portion of an IRA balance to your ex ***only if*** the transfer is *ordered* by a divorce or separation instrument. For this purpose, the tax code narrowly defines a divorce or separation instrument as a "decree of divorce or separate maintenance or a written instrument incident to such a decree."

TCJA Eliminates Alimony Tax Deduction

How do you counteract loss of alimony deductions? The federal income tax deduction for alimony payments required by divorce agreements executed after 2018 was permanently eliminated by the TCJA.

If you are a higher-income individual, this TCJA post-2018 development is an expensive game-changer for you. In the pre-TCJA days, you as a higher-income individual could reap big tax savings from deducting alimony payments, but those tax savings are history.

What can you do now that those deductions have been eliminated? One thing is to transfer assets with tax liabilities to your soon-to-be-ex (such as qualified plan and IRA balances, appreciated stock and mutual fund shares, and ownership of your highly appreciated vacation home).

Disassociating yourself from tax liabilities is effectively the same as getting a deduction. In a divorce, make it your mission to try to keep ownership of assets that have no tax liabilities, such as your Roth IRA.

Stock Redemption

If your business is incorporated and your soon-to-be-ex is a part owner, another idea is to arrange for a stock redemption deal to buy out your ex's shares in lieu of making nondeductible alimony payments. With proper planning, you can arrange for your ex to bear the tax consequences of the redemption.

As you can see, there's much to consider in a divorce.

Tips for the Self-Employed Age 50 and Older

If you are self-employed, you have much to think about as you enter your senior years, and that includes retirement savings and Medicare. Here a few thoughts that will help.

Keep Making Retirement Account Contributions, and Make Extra “Catch-up” Contributions Too

Self-employed individuals who are age 50 and older as of the applicable year-end can make additional elective deferral *catch-up contributions* to certain types of tax-advantaged retirement accounts.

For the 2019 tax year, you can take advantage of this opportunity if you will be 50 or older as of December 31, 2019.

- You can make elective deferral catch-up contributions to your self-employed 401(k) plan or to a SIMPLE IRA.
- You can also make catch-up contributions to a traditional or Roth IRA.

The maximum catch-up contributions for 2019 are as follows:

401(k) Plan	SIMPLE IRA	Traditional or Roth IRA
$6,000	$3,000	$1,000

Catch-up contributions are above and beyond

1. “regular” 2019 elective deferral contribution limit of $19,000 that otherwise applies to a 401(k) plan.
2. “regular” 2019 elective deferral contribution limit of $13,000 that otherwise applies to a SIMPLE IRA.
3. “regular” 2019 contribution limit of $6,000 that otherwise applies to a traditional or Roth IRA.

How Much Can Those Catch-up Contributions Be Worth?

Good question. You might dismiss catch-up contributions as relatively inconsequential unless we can prove otherwise. Fair enough. Here’s your proof:

401(k) catch-up contributions. Say you turned 50 during 2019 and contributed on January 1, 2019, an extra $6,000 for this year to your self-employed 401(k) account and then did the same for the following 15 years, up to age 65. Here’s how much extra you could accumulate in your 401(k) account by the end of the year you reach age 65, assuming the indicated annual rates of return below:

4% Return	6% Return	8% Return
$136,185	$163,277	$196,501

Is There an Upper Age Limit for Regular and Catch-up Contributions?

Another good question.

While you must begin taking annual required minimum distributions (RMDs) from a 401(k), SIMPLE IRA, or traditional IRA account after reaching age 70 1/2, you can continue to contribute to your 401(k), SIMPLE IRA, or Roth IRA account after reaching that age, as long as you have self-employment income (subject to the income limit for annual Roth contribution eligibility).

But you may not contribute to a traditional IRA after reaching age 70 1/2.

Claim a Self-Employed Health Insurance Deduction for Medicare and Long-Term Care Insurance Premiums

If you are self-employed as a sole proprietor, an LLC member treated as a sole proprietor for tax purposes, a partner, an LLC member treated as a partner for tax purposes, or an S corporation shareholder-employee, you can generally claim an above-the-line deduction for health insurance premiums, including Medicare health insurance premiums, paid for you or your spouse.

Key point. You don't need to itemize deductions to get the tax-saving benefit from this above-the-line self-employed health insurance deduction.

Medicare Part A Premiums

Medicare Part A coverage is commonly called *Medicare hospital insurance*. It covers inpatient hospital care, skilled nursing facility care, and some home health care services. You don't have to pay premiums for Part A coverage if you paid Medicare taxes for 40 or more quarters during your working years. That's because you're considered to have paid your Part A premiums via Medicare taxes on wages and/or self-employment income.

But some individuals did not pay Medicare taxes for enough months while working and must pay premiums for Part A coverage.

- If you paid Medicare taxes for *30-39 quarters*, the 2019 Part A premium is $240 per month ($2,880 if premiums are paid for the full year).
- If you paid Medicare taxes for *less than 30 quarters*, the 2019 Part A premium is $437 ($5,244 for the full year).
- Your spouse is charged the same Part A premiums if he or she paid Medicare taxes for less than 40 quarters while working.

Medicare Part B Premiums

Medicare Part B coverage is commonly called *Medicare medical insurance or Original Medicare.* Part B mainly covers doctors and outpatient services, and Medicare-eligible individuals must pay monthly premiums for this benefit.

Your monthly premium for the current year depends on your modified adjusted gross income (MAGI) as reported on Form 1040 for two years earlier. For example, your 2019 premiums depend on your 2017 MAGI.

MAGI is defined as "regular" AGI from your Form 1040 plus any tax-exempt interest income.

Base premiums. For 2019, most folks pay the base premium of $135.60 per month ($1,627 for the full year).

Surcharges for higher-income individuals. Higher-income individuals must pay surcharges in addition to the base premium for Part B coverage.

For 2019, the Part B surcharges depend on the MAGI amount from your 2017 Form 1040. Surcharges apply to unmarried individuals with 2017 MAGI in excess of $85,000 and married individuals who filed joint 2017 returns with MAGI in excess of $170,000.

Including the surcharges (which go up as 2017 MAGI goes up), the 2019 Part B monthly premiums for each covered person can be $189.60 ($2,275 for the full year), $270.90 ($3,251 for the full year), $352.20 ($4,226 for the full year), $433.40 ($5,201 for the full year), or $460.50 ($5,526 for the full year).

The maximum $460.50 monthly premium applies to unmarried individuals with 2017 MAGI in excess of $500,000 and married individuals who filed 2017 joint returns with MAGI in excess of $750,000.

Medicare Part D Premiums

Medicare Part D is private prescription drug coverage. Premiums vary depending on the plan you select. Higher-income individuals must pay a surcharge in addition to the base premium.

Surcharges for higher-income individuals. For 2019, the Part D surcharges depend on your 2017 MAGI, and they go up using the same scale as the Part B surcharges.

The 2019 monthly surcharge amounts for each covered person can be $12.40, $31.90, $51.40, $70.90, or $77.40. The maximum $77.40 surcharge applies to unmarried individuals with 2017 MAGI in excess of $500,000 and married individuals who filed 2017 joint returns with MAGI in excess of $750,000.

Medigap Supplemental Coverage Premiums

Medicare Parts A and B do not pay for all health care services and supplies. Coverage gaps include copayments, coinsurance, and deductibles.

You can buy a so-called *Medigap* policy, which is private supplemental insurance that's intended to cover some or all of the gaps. Premiums vary depending on the plan you select.

Medicare Advantage Premiums

You can get your Medicare benefits from the government through Part A and Part B coverage or through a so-called *Medicare Advantage plan* offered by a private insurance company. Medicare Advantage plans are sometimes called Medicare Part C.

Medicare pays the Medicare Advantage insurance company to cover Medicare Part A and Part B benefits. The insurance company then pays your claims. Your Medicare Advantage plan may also include prescription drug coverage (like Medicare Part D), and it may cover dental and vision care expenses that are not covered by Medicare Part B.

When you enroll in a Medicare Advantage plan, you continue to pay Medicare Part A and B premiums to the government. You may pay a separate additional monthly premium to the insurance company for the Medicare Advantage plan, but some Medicare Advantage plans do not charge any additional premium. The additional premium, if any, depends on the plan that you select.

Key point. Medigap policies do not work with Medicare Advantage plans. So if you join a Medicare Advantage plan, you should drop any Medigap coverage.

Premiums for Qualified Long-Term Care Insurance

These premiums also count as medical expenses for purposes of the above-the-line self-employed health insurance premium deduction, subject to the age-based limits shown below. For each covered person, count the lesser of premiums paid in 2019 or the applicable age-based limit.

Your age as of December 31, 2019, determines your maximum self-employed health insurance tax deduction for your long-term care insurance as follows:

- $790—ages 41-50
- $1,580—ages 51-60
- $4,220—ages 61-70
- $5,270—over age 70

The Home Office Deduction

Qualifying for a tax deduction

Entrepreneurs who work from home can write off a portion of their housing and utility expenses.

A sole proprietor who uses 25% of her house as an office, for example, can deduct 25% of her rent or mortgage interest, property tax, homeowners or renter's insurance, and utilities.

To qualify for the home office deduction, entrepreneurs must have a dedicated space in their home that they use exclusively and regularly for business. IRS agents often focus on these two factors when auditing tax returns claiming the home office deduction. So, it's important you know what each of these factors mean.

- Dedicated space used exclusively for business. A home office doesn't have to be an entire room. It could be a desk and file cabinet sitting in a corner of a room. But, this area of the house must be used only for business, and nothing else. Using the room for recreation or having the kids do their homework at the desk means that the space is not exclusively used for business. And that would result in no home office deduction for that space.
- Regularly and consistently use the space for business. You don't have to work in your home office every single day. But you do need to use the space for business on a regular basis. Working from home only occasionally isn't enough. A dentist who sees clients in her home office only in emergencies, for example, might not be using the space regularly enough to qualify for the deduction.
- Storage of inventory. If you run a wholesale or retail business, you can also take a home office deduction for the area used to store your inventory and product samples. This storage area does not need to meet the exclusive use test. As long as you use the storage area on a regular basis, we can deduct the storage area in addition to the space you use for conducting business. This is a valuable deduction for eBay sellers and other merchants whose home is the only fixed location for their business.
- Childcare, senior care, and adult daycare. Day care providers can deduct the area of the home used for providing daycare services. The area doesn't have to be used exclusively for business. Instead, we take a deduction based on the amount of time the area is used for business.

Let us know if you work from home. We want to be armed with facts in case the IRS decides to ask any questions.

Avoid passport revocation

Pay your tax debt

The IRS is urging taxpayers to resolve their significant tax debts to avoid putting their passports in jeopardy. If you owe a serious tax debt, which is currently $52,000 or more, the IRS will notify the State Department. Subsequently, the State Department is required to deny any passport application or renewal for such taxpayers. If you are delinquent and currently have a valid passport, the State Department may revoke the passport or limit your ability to travel outside the United States.

If the IRS certifies you as owing a seriously delinquent tax debt, you will receive a notice that explains what steps you need to take to resolve the debt. There are several ways you can avoid having the IRS notify the State Department of seriously delinquent tax debt.

If you think you are in this situation, contact me to discuss how we can work together to resolve any tax debt, even if you haven't received a notice yet.

Employer Identification Number

Does my business need one?

An Employer Identification Number (EIN) is a nine-digit number that the IRS assigns to identify tax accounts. It's also referred to as a Federal Tax Identification Number.

When deciding if your business needs to obtain an EIN, consider the following questions:

- Will you have employees?
- Will you operate your business as a corporation or partnership?
- Will you file employment, excise, or alcohol, tobacco and firearms tax returns?
- Will you withhold taxes on income, other than wages, paid to a non-resident alien?
- Will you have a retirement plan?
- Will you be involved with: (1) trusts, except certain grantor-owned revocable trusts, IRAs, exempt organization business income tax returns; (2) estates; (3) real estate mortgage investment conduits; (4) non-profit organizations; (5) farmers' cooperatives; or (6) plan administrators?

If you answered "yes" to any of the above, then you need to obtain an EIN.

Generally, businesses need a new EIN when their ownership or structure has changed. And it's important to note that if you are applying for tax-exempt status, be sure that your organization is formed legally before applying for an EIN.

Applying for an EIN is a free service offered by the IRS. An EIN can be obtained online, by fax, mail or telephone. All EIN applications must disclose the "responsible party." This is the person or entity who controls, manages or directs the applicant entity and the disposition of its funds and assets. Unless the applicant is a government, the responsible party must be an individual, not an entity.

Thinking of starting a new venture? Let's start by tackling the EIN application together.

QUIK TIPS

1. If by year-end you haven't contributed funds to your IRA, or if you've put in less than the maximum allowed, don't worry. You can contribute to either a traditional or Roth IRA up until the April due date for filing your tax return. Your employer contributions to a Keogh, SEP, or a SIMPLE plan are due by the time you file your tax return unless you have a valid extension then you have until the extended due date to make the contribution.

2. Are you planning on making any substantial gifts? Talk to me first. For 2019 & 2020, gifts with values exceeding $15,000 must be reported to the IRS.

3. The standard mileage rates for the use of a car, including vans, pickups, or panel trucks in 2020 are:

- 57.5 cents per mile for BUSINESS USE
- 17 cents per mile for all miles driven for medical or moving purposes; and
- 14 cents per mile for all miles driven for charitable purposes.

4. Did you know that there is still up to a $7,500 dollar tax credit for purchasing a qualified electric plug-in vehicle like a Tesla? Call me for all the details.

5. As a self-employed taxpayer, you may contribute to a sole-owner 401(k) retirement plan as both an employer and as an employee. As an employer, you may contribute up to 25 percent of your total income to your retirement plan. As an employee, you may also contribute up to an additional $19,000 in 2019 ($25,000) if age 50 or over). Your maximum contribution to an individual 401(k) plan is the lesser of $62,000 or the sum of the employer and employee maximums. Unlike other retirement plans such as SEPS and SIMPLE IRAs, an individual 401(k) plan allows you to take out loans from plan assets.

6. The Federal Estate Tax exemption for 2019 is $11,400,000. The rate is 40%. Additionally, heirs get to use stepped-up basis to value assets inherited. The exemption in MA, ME & NY is only $1 million with a top tax rate of 16%.

7. In 2019 the tax rate of 37 percent will affect individuals and Heads of Households whose taxable income exceeds $510,301 ($612,351 for married taxpayers filing a joint return).

8. If you turned age 70 on July 1, 2019 or later you are not required to begin your required minimum distributions (RMD) from your IRA until your 72nd birthday thanks to the just passed Secure Act. Now, RMDs must start no later than your 72nd birthday. Failure to do so results in a 50 percent penalty on the amount you do not take.

9. Long Term Care Premiums may be tax deductible with limits based on your age and whether you itemize deductions. Self-employed taxpayers may include the allowable premiums with their self-employed health insurance whether they itemize or not.

Maximizing student financial aid

Seven tax strategies

What's on your tax return plays a big role in determining how much financial aid a college offers to students. To get the most financial aid possible, you need to plan out any tax moves several years before applying.

Colleges look at the income and assets of the parents and the student when calculating the "expected family contribution," which in turn is used to calculate a student's need for financial aid. But schools don't look at last year's income. Instead they look at income reported two years before the start of the school year. Financial aid for the 2021–2022 school year, for example, will be based in part on how much adjusted gross income (AGI) is reported on your 2019 tax return.

Keeping AGI as low as possible can help result in a better financial aid package for the college student. Here are seven techniques that parents and future college students can use to lower their adjusted gross income:

- Avoid taking unnecessary distributions from IRAs and other retirement plans.
- Avoid selling stocks and investments with large capital gains, as this will increase your income.
- Consider selling investments that have lost value so you can take a capital loss, which in turn reduces your AGI.
- Consider selling rental property. In some situations, this can unlock accumulated passive losses and significantly reduce your AGI.
- Consider working abroad and claiming the foreign earned income exclusion. This can reduce your AGI by up to $105,900 for tax year 2019.
- Consider increasing contributions to a pre-tax 401(k) or 403(b) plan. This reduces your taxable wages, which in turn lowers your AGI.
- Consider making tax-deductible contributions to a traditional IRA, self-employed retirement plan, or health savings account. These deductions reduce your AGI.

As your tax adviser, I can help you figure out which strategies will work best for keeping your AGI as low as possible.

A Final Word from Charlie

I hope your holiday season was enjoyable. As the 2019 year-end approached, I received quite a few emails and calls on a variety of subjects relating to taxes. So, I publish this newsletter to provide you some tax saving tips and to keep you abreast of some of the nuances in the tax code.

In addition to preparing your tax return for you I can assist you with retirement income planning. I can help you save for your retirement through a variety of plans that will grow with the market without any risk of losing your money, guaranteed! Don't wait any longer. Contact me today so I can help you accomplish your retirement goals.