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SEPTEMBER 2018

MANDI R. KILLIAN – NEW CPA

We were very pleased to learn recently that Mandi Killian has successfully completed the CPA exam. Mandi came to work with us in May 2018 after having graduated with a Master of Accountancy degree from Louisiana Tech University.

Notably, Mandi passed the CPA exam on her first attempt.

We are very happy with Mandi in her success and are very fortunate to have her services.

REQUIRED DISTRIBUTIONS FROM QUALIFIED PLANS AND IRAS DUE DECEMBER 31, 2018

As you might recall, participants in qualified plans and owners of traditional IRAs who are age 70½ or older generally must receive required minimum distributions from the plan and IRAs on or before December 31, 2018. The minimum distributions are based on the December 31, 2017 account balances and life expectancy of the participant/owner.

The penalty for failure to take a required distribution is substantial (50 percent of the undistributed amount). If you have received required minimum distributions in the past, a distribution will probably be required for 2018. If you believe that you are required to take a minimum distribution from a plan or IRA, the qualified plan administrator or IRA custodian should be made aware and will help with making an appropriate distribution.

The IRA custodian is not responsible for

computing the required minimum distribution from the IRA. In the case of multiple IRAs with different custodians, each custodian will not be aware of the information necessary to compute the minimum required distribution. Most IRA custodians will assist the participant in computing the required minimum distribution, but the ultimate responsibility is on the IRA participant. Thus, it is administratively convenient (and probably in the best interest of the taxpayer) to have only one traditional IRA once the taxpayer has reached age 70½. Roth IRAs, of course, do not have required distributions prior to the death of the original owner or death of the surviving spouse if the spouse was the beneficiary.

We will be happy to answer any questions you might have concerning required minimum distributions or distribution planning in general.

TAX PLANNING FOR 2018

CHARITABLE GIVING

For the past few months we have discussed changes applicable to 2018 income taxes that taxpayers might want to consider in their year-end planning. Our May 2018 Newsletter discussed the elimination of tax deductions for investment fees, June 2018 covered the unlimited and immediate write-off of certain depreciable property, including business vehicles, and August 2018 discussed the new and punishing results for taxpayers receiving income from activities that the Internal Revenue Service (IRS) determines to be an activity not engaged in for a profit – that the activity is determined by the IRS to be a “hobby.” Our prior newsletters are available on our website www.cepcpa.com. This month, we briefly discuss charitable contributions under the new law and the proposed regulations released on August 23, 2018.

New Law

The maximum deduction for cash contributions has been raised to 60 percent of adjusted gross income for 2018 through 2025, up from 50 percent for 2017. While this is a favorable change, its overall impact is very small because the 50 percent limit was so large that it applied to a limited number of taxpayers. Many more taxpayers will benefit from the new and much higher standard deduction and, possibly, the “bunching” of charitable contributions. The standard deduction for 2018 has been increased to \$24,000 for married, joint filing couples, to \$18,000 for heads of households, and to \$12,000 for others. Some middle-income taxpayers with charitable giving and without large home mortgage interest deductions will benefit from alternating their charitable contributions between years by doubling their charitable contributions in one year and skipping the next year in which the standard deduction is used.

Also, charitable givers who are age 70½ or over and are receiving required minimum distributions from one or more traditional IRAs might consider making their charitable contributions directly from their IRA as a Qualified Charitable Distribution (QCD). For a taxpayer who

will be using the standard deduction rather than itemized deductions, this will result in having the benefit of both the standard deduction and the charitable contribution deduction, which would otherwise be lost.

Proposed Regulations on State and Local Tax Deduction as a Charitable Contribution

As mentioned in our July Newsletter, some states with high state income taxes have considered plans that would allow a state income tax credit for contributions to a state sponsored charity. The contribution, they asserted, would result in a federal charitable contribution deduction – that is, in effect, an indirect federal deduction of their state’s income taxes in amounts above the statutory limit (\$10,000) for a federal deduction of state and local taxes.

On August 23, 2018, the IRS issued proposed regulations to clarify the relationship between state and local tax credits and the federal tax rules for charitable contribution deductions. Under the proposed regulations, a taxpayer who makes payments or transfers property to an entity eligible to receive federally tax deductible contributions must reduce that taxpayer’s charitable contribution deduction by the amount of any state and local tax credit the taxpayer receives or expects to receive as the result of that contribution. For example, if a state grants a 90 percent tax credit for contributions to an eligible charity, a taxpayer who contributes \$1,000 to the eligible entity must reduce his federal contribution deduction by the \$900 state tax credit received leaving an allowable deduction of \$100.

This is similar treatment that has, for many years, been required for charitable contributions to tax-exempt athletic foundations of state universities where the IRS required the gross contributions to be reduced by the value of the tickets received. The proposed regulations are intended, and we believe their final results will be, to prevent the deduction of state and local taxes as charitable contributions.

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Tax & Business Alert

SEPTEMBER 2018

TCJA DRAWS A SILVER LINING AROUND THE INDIVIDUAL AMT

The Tax Cuts and Jobs Act (TCJA) didn't eliminate the individual alternative minimum tax (AMT). But the law did draw a silver lining around it. Revised rules now lessen the likelihood that many taxpayers will owe substantial taxes under the AMT for 2018 through 2025.

PARALLEL UNIVERSE

Think of the AMT as a parallel universe to the regular federal income tax system. The difference: The AMT system taxes certain types of income that are tax-free under the regular tax system and disallows some regular tax deductions and credits.

The maximum AMT rate is 28%. By comparison, the maximum regular tax rate for individuals has been reduced to 37% for 2018 through 2025 thanks to the TCJA. For 2018, that 28% AMT rate starts when AMT income exceeds \$191,100 for married joint-filing couples and \$95,550 for others (as adjusted by Revenue Procedure 2018-18).

EXEMPTION AVAILABLE

Under the AMT rules, you're allowed a relatively large inflation-adjusted AMT exemption. This amount is deducted when calculating your AMT income. The TCJA significantly increases the exemption for 2018 through 2025. The exemption is phased out when your AMT income surpasses the applicable

threshold, but the TCJA greatly increases those thresholds for 2018 through 2025.

If your AMT bill for the year exceeds your regular tax bill, you must pay the higher AMT amount. Originally, the AMT was enacted to ensure that very wealthy people didn't avoid paying tax by taking advantage of "too many" tax breaks. Unfortunately, the AMT also hit some unintended targets. The new AMT rules are better aligned with Congress's original intent.



Under both old and new law, the exemption is reduced by 25% of the excess of AMT income over the applicable exemption amount. But under the

HIGH-INCOME EARNERS BACK IN THE AMT SPOTLIGHT

Before the Tax Cuts and Jobs Act (TCJA), many high-income taxpayers weren't affected by the alternative minimum tax (AMT). That's because, after multiple legislative changes, many of their tax breaks were already cut back or eliminated under the regular income tax rules. So, there was no need to address the AMT.

If one's income exceeds certain levels, phaseout rules chip away or eliminate other tax breaks. As a result, higher-income taxpayers had little or nothing left to lose by the time they got to the AMT calculation, while many upper-middle-income folks still had plenty left to lose. Also, the highest earners were in the 39.6% regular federal income tax bracket under prior law, which made it less likely that the AMT — with its maximum 28% rate — would hit them.

In addition, the AMT exemption is phased out as income goes up. This amount is deducted in calculating AMT income. Under previous law, this exemption had little or no impact on individuals in the top bracket, because the exemption was completely phased out. But the exemption phaseout rule made upper-middle-income taxpayers more likely to owe AMT under previous law. Suffice it to say that, under the TCJA, high-income earners are back in the AMT spotlight. So, proper planning is essential.

TCJA, only those with high incomes will see their exemptions phased out, while others — particularly middle-income taxpayers — will benefit from full exemptions.

NEED TO PLAN

For many taxpayers, the AMT rules are less worrisome than they used to be. Let our firm assess your liability and help you plan accordingly. ■

HOW SPOUSE-OWNED BUSINESSES CAN REDUCE SELF-EMPLOYMENT TAXES

If you own a profitable, unincorporated business with your spouse, you probably find the high self-employment (SE) tax bills burdensome. An unincorporated business in which both spouses are active is typically treated by the IRS as a partnership owned 50/50 by the spouses. (For simplicity, when we refer to “partnerships,” we'll include in our definition limited liability companies that are treated as partnerships for federal tax purposes.)

For 2018, that means you'll each pay the maximum 15.3% SE tax rate on the first \$128,400 of your respective shares of net SE income from the business.



Those bills can mount up if your business is profitable. To illustrate: Suppose your business generates \$250,000 of net SE income in 2018. Each of you will owe \$19,125 ($\$125,000 \times 15.3\%$), for a combined total of \$38,250. Fortunately, there may be ways your spouse-owned business can lower your combined SE tax hit.

DIVORCE YOURSELF FROM THE CONCEPT

While the IRS creates the impression that involvement by both spouses in an unincorporated business automatically creates a partnership for federal tax purposes, in many cases it will have a tough time making the argument — especially when the spouses have no discernible partnership agreement and the business hasn't been represented as a partnership to third parties (such as banks and customers).

If you can establish that your business is a sole proprietorship (or a single-member LLC treated as a sole proprietorship for tax purposes), only the spouse who is considered the proprietor owes SE tax. So, let's assume the same facts as in the previous example, except that your business is a sole proprietorship operated by one spouse. Now you have to calculate SE tax for only that spouse. For 2018, the SE tax bill is \$23,172 [$(\$128,400 \times 15.3\%) + (\$121,600 \times 2.9\%)$].

Medicare tax)]. That's much less than the combined SE tax bill from the first example (\$38,250).

SHOW A LOPSIDED OWNERSHIP PERCENTAGE

Even if you do have a spouse-owned partnership, it's not a given that it's a 50/50 one. Your business might more properly be characterized as owned, say, 80% by one spouse and 20% by the other spouse, because one spouse does much more work than the other.

Let's assume the same facts as in the first example, except that your business is an 80/20 spouse-owned

partnership. In this scenario, the 80% spouse has net SE income of \$200,000, and the 20% spouse has net SE income of \$50,000. For 2018, the SE tax bill for the 80% spouse is \$21,722 [(\$128,400 × 15.3%) + (\$71,600 × 2.9%)], and the SE tax bill for the 20% spouse is \$7,650 (\$50,000 × 15.3%). The combined total SE tax bill is only \$29,372 (\$21,722 + \$7,650).

EXPLORE ALL STRATEGIES

More-complicated strategies are also available. Contact us to learn more about how you can reduce your spouse-owned business's SE taxes. ■

STUDY UP ON THE TAX ADVANTAGES OF A 529 SAVINGS PLAN

With kids back in school, it's a good time for parents (and grandparents) to think about college funding. One option, which can be especially beneficial if the children in question still have many years until heading off to college, is a Section 529 plan.

TAX-DEFERRED COMPOUNDING

529 plans are generally state-sponsored, and the savings-plan option offers the opportunity to potentially build up a significant college nest egg because of tax-deferred compounding. So, these plans can be particularly powerful if contributions begin when the child is young. Although contributions aren't deductible for federal purposes, plan assets can grow tax-deferred. In addition, some states offer applicable state tax incentives.

Distributions used to pay qualified expenses (such as tuition, mandatory fees, books, supplies, computer-related items and, generally, room and board) are income-tax-free for federal purposes and, in many cases, for state purposes as well. (The Tax Cuts and Jobs Act changes the definition of "qualifying expenses" to include not just postsecondary school costs, but also primary and secondary school expenses.)

ADDITIONAL BENEFITS

529 plans offer other benefits, too. They usually have high contribution limits and no income-based phaseouts to limit contributions. There's generally no beneficiary age limit for contributions or distributions. And the owner can control the account — even after the child is a legal adult — as well as make tax-free rollovers to another qualifying family member.



Finally, 529 plans provide estate planning benefits: A special break for 529 plans allows you to front-load five years' worth of annual gift tax exclusions, which means you can make up to a \$75,000 contribution (or \$150,000 if you split the gift with your spouse) in 2018. In the case of grandparents, this also can avoid generation-skipping transfer taxes.

MINIMAL MINUSES

One negative of a 529 plan is that your investment options are limited. Another is that you can make changes to your options only twice a year or if you change the beneficiary.

But whenever you make a new contribution, you can choose a different option for that contribution, no matter how many times you contribute during the year. Also, you can make a tax-free rollover to another 529 plan for the same child every 12 months.

MORE TO LEARN

We've focused on 529 savings plans here; a prepaid tuition version of 529 plans is also available. If you'd like to learn more about either type of 529 plan, please contact us. ■

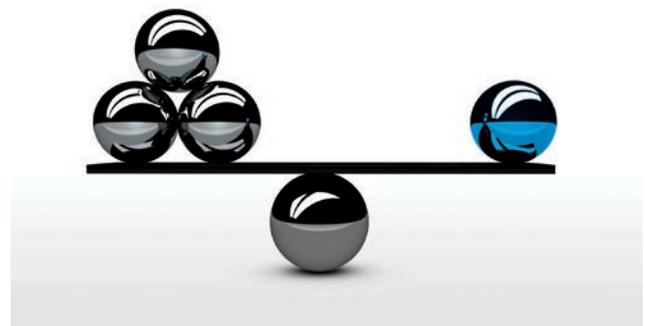
WHEN IS BARTERING TAXABLE?

The notion of bartering may conjure an image of a crowded, bustling medieval bazaar. Dusty travelers, farmers perchance, haggle with merchants over textiles or metal tools. Live chickens are exchanged for handspun cloth and, eventually, everyone goes home happy.

Although usually less dusty, these types of transactions continue to occur in today's high-tech modern world. In fact, it's not unusual for small businesses — especially start-ups that are short on capital — to exchange goods or services instead of cash.

For example, a microbrewery might ask the graphic designer across the street to design its logo in exchange for several cases of beer. Contrary to popular belief, these bartering transactions are taxable. In this case, the graphic design company would be required to include the fair market value of the beer in its gross income.

Granted, an informal transaction like this may fly under the IRS's radar. But business owners who



engage in bartering should know that the value of products or services involved in these kinds of deals is generally considered taxable income. (And this is true even if you're *not* a business.)

Companies involved in bartering may be required to file Form 1099-MISC. The penalties for failure to file can be harsh. Also, if you use a barter exchange to broker trades with other businesses, the exchange is required to report the proceeds on Form 1099-B. Contact our firm for further details. ■