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APRIL 2018

THANKS

"Gratitude unlocks the fullness of life…it can turn a meal into a feast,
a house into a home, a stranger into a friend." – Melody Beattie

As is our tradition, we will celebrate the April 17, 2018 end of tax season (the 17th is the last day to file as the 15th falls on Sunday and the 16th is a federal holiday) by closing for our traditional post-season holiday on Wednesday, April 18, 2018. We will honor our staff with an Appreciation Luncheon and will close at 11:30 a.m. on Friday, April 20, 2018. The Computer Center will be open on Wednesday, April 18, 2018 and will close at 11:30 on Friday, April 20, 2018. We are grateful to our clients for the opportunity of working for them and to our staff for their excellent performance. To both we say – **THANK YOU!**

CHARITABLE DONATIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS

The new tax law effective for 2018 increases the individual standard deduction and eliminates some itemized deductions. Consequently, many taxpayers who previously itemized deductions on their tax returns will now claim the standard deduction. For almost all taxpayers using the standard deduction, the tax benefit from charitable donations will be entirely eliminated.

However, taxpayers over age 70½ with an Individual Retirement Account (IRA) may use the standard deduction and also receive the tax benefits of a charitable contribution.

A Qualified Charitable Donation is a donation made directly from an IRA to a church or other public charity. That direct charitable transfer is considered a distribution from the IRA (and counts as part of the required minimum distribution for those over age 70½), but it is excluded from the IRA owner's taxable income. In other words, one can obtain the tax benefit of the donation (by reduced taxable income) and also benefit from the full standard deduction.

So, for taxpayers taking annual required minimum distributions from an IRA, this might be a tax-wise way to make a charitable contribution. If you believe that you might benefit from a direct donation from your IRA, we will be happy to discuss it with you.

DISPUTES TO INCREASE

"Beauty is in the Eye of the Beholder" – Margaret Wolfe Hungerford

The accompanying *Tax & Business Alert* includes an article on reasonable compensation, which discusses the reasonableness of owner's compensation in tax matters, shareholder disputes, divorce cases, etc. The Internal Revenue Service (IRS) and taxpayers have long disputed what is reasonable compensation for owners. The IRS frequently argues for lower compensation in C corporation cases (increasing the corporate level income tax) and for higher compensation in S corporation cases (increasing payroll taxes). Not mentioned in the article is the new significance of owner's "reasonable compensation" paid by pass-through entities (partnerships, LLCs, sole proprietorships, S corporations, etc.) in computing the new qualified business income deduction (QBID) for pass-through entities. This deduction reduces taxable income by 20 percent of the net income from the qualified trade or business. The qualified business net income is computed after a deduction for "reasonable compensation and guaranteed payments for services rendered with respect to the qualified trade or business." Accordingly, higher compensation to the owner/taxpayer will result in a lower net income from the qualified business, a smaller QBID, and increased taxable income. A lower compensation will increase the qualified business income deduction and result in lower total taxable income and tax. Because reasonable is within a range of values, not a specific value, a significant portion of business "profits" may be characterized as compensation and taxed at a federal rate of up to 37 percent or characterized as qualified business income and taxed at a federal rate of up to 29.6 percent (37% - 20% of 37% = 29.6%). The definition of "reasonable compensation" has now become even more important. Accordingly, disputes over the meaning of "reasonable compensation" are almost certain to increase. Like beauty, the definition of "reasonable compensation" depends on the eye of the beholder.

PROOF OF TIMELY PAYMENT

Proof of timely filing of individual federal and state income tax returns has become easier for taxpayers using professional preparers as almost all such returns are required to be filed electronically. The tax preparer receives an electronic receipt, which can be used by the taxpayer to prove the date of filing. Similarly, payment of tax by electronic transfer furnishes proof of payment. Not so, however, with proof of payment by check.

Generally, payment by check is deemed timely made when it is timely mailed with proper postage and a proper address. If the payment is misdirected or lost and then later discovered with a legible postmark showing timely mailing, no problems should arise. If the postmark shows a date after the due date of the payment or if the postmark is illegible, the Internal Revenue Service considers the payment as made when actually received.

A Registered or Certified Mail receipt stamped by the Post Office showing a timely date of mailing and a canceled check will suffice to prove timely payment. A timely dated check that clears the payers' bank a few days after the due date of the payment will not prove timely payment. The failure-to-pay penalty (one-half of one percent per month up to 25 percent) is much smaller than the failure-to-file penalty, which is usually five percent of the tax owed for each month or part of a month that a return is late, up to a maximum of 25 percent. It is, then, more significant to be able to prove timely filing than timely payment. One might prudently use routine mailing for relatively small payments where the penalty for a late payment would be minimal. However, we suggest that all significant payments (and documents if applicable) be mailed to the Internal Revenue Service via U.S. Postal Service Certified Mail with the "Return Receipt Requested" and that taxpayers have the Post Office stamp the mailing date on their receipt. Unfortunately, timely action in a tax matter is not enough – the taxpayer is required to prove timeliness or suffer what, in some cases, are significant penalties.

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Tax & Business Alert

APRIL 2018

GETTING TO KNOW YOUR CREDIT AND DEBIT CARDS A BIT BETTER

Virtually everyone has a credit and debit card these days. But many of us still live in fear of these plastic necessities because we're not terribly familiar with the fine print of the arrangements under which they operate. Let's get to know them a bit better.

CREDIT CARDS

If your credit card is used without your permission, you may be responsible for up to $50 in charges, according to the Federal Trade Commission (FTC). If your card is lost or stolen and you report the loss before your card is used in a fraudulent transaction, you can't be held responsible for any unauthorized charges. Some card issuers protect customers regardless of when — or if — they notify the card company.

When reporting a card loss or fraudulent transaction, contact the card company via phone; many provide toll-free numbers that are answered around the clock. In addition, the FTC advises following up via a letter or email. It should include your account number, the date you noticed the card was missing (if applicable), and the date you initially reported the card loss or fraudulent transaction.

DEBIT DANGERS

Debit card liability can be a little riskier. It generally depends on whether the card was lost or stolen or is still in your possession, the type of transaction, and when you reported the loss or unauthorized transaction.

According to the FTC, if you report a missing debit card before any unauthorized transactions are made, you aren't responsible for the unauthorized transactions. If you report a card loss within two business days after you learn of the loss, your maximum liability for unauthorized transactions is $50.

If you report the card loss after that time but within 60 calendar days of the date your statement showing an unauthorized transaction was mailed, liability can jump to $500. Finally, if you report the card loss more than 60 calendar days after your statement showing unauthorized transactions was mailed, you could be liable for all the funds taken from your account.

If you notice an unauthorized debit card transaction on your statement, but your card is in your possession, you have 60 calendar days after the statement showing the unauthorized transaction is mailed to report it and still avoid liability.

While the lower protections required on debit cards may make you wonder whether you're safer using a credit card, some debit card companies offer protections that go above what the law requires. Check with your provider.

RISK MANAGEMENT STEPS

Taking a few simple steps can help cut the risk that you'll be held liable for unauthorized use of your credit or debit card. First, carry only cards you need and destroy old ones, shredding them if possible. Don't provide your card number over the phone or online unless you've initiated the contact.

In addition, choose a PIN that's not easily guessed and make sure to memorize it. If you have online access, take a few moments to scan transactions every time you log on or at least once a week. If you still use paper statements, be sure to review them when they arrive in the mail. If you notice a transaction that isn't yours, report it to your credit card issuer or bank right away.

Finally, keep a list of important numbers and relevant data stored separately from the cards themselves. Having this information handy will make it easier to report a missing card or suspicious transaction quickly.

INS AND OUTS

Many of us have grown so familiar with our credit and debit cards that we take them for granted. But keep in touch with their ins and outs. We can answer any further questions you may have. ■

NO KIDDING: CHILD CREDIT TO GET EVEN MORE VALUABLE

The child credit has long been a valuable tax break. But, with the passage of the Tax Cuts and Jobs Act (TCJA) late last year, it's now even better — at least for a while. Here are some details that every family should know.

AMOUNT AND LIMITATIONS

For the 2017 tax year, the child credit may help reduce federal income tax liability dollar-for-dollar by up to $1,000 for each qualifying child under age 17. So if you haven't yet filed your personal return or you might consider amending it, bear this in mind.

The credit is, however, subject to income limitations that may reduce or even eliminate eligibility for it depending on your filing status and modified adjusted gross income (MAGI). For 2017, the limits are $110,000 for married couples filing jointly, and $55,000 for married taxpayers filing separately. (Singles, heads of households, and qualifying widows and widowers are limited to $75,000 in MAGI.)

EXCITING CHANGES

Now the good news: Under the TCJA, the credit will double to $2,000 per child under age 17 starting in 2018. The maximum amount refundable (because a taxpayer's credits exceed his or her tax liability) will be limited to $1,400 per child.

The TCJA also makes the child credit available to more families than in the past. That's because, beginning in 2018, the credit won't begin to phase out until MAGI exceeds $400,000 for married couples or $200,000 for all other filers, compared with the 2017 phaseouts of $110,000 and $75,000. The phaseout thresholds won't be indexed for inflation, though, meaning the credit will lose value over time.

In addition, the TCJA includes (starting in 2018) a $500 nonrefundable credit for qualifying dependents other than qualifying children (for example, a taxpayer's 17-year-old child, parent, sibling, niece or nephew, or aunt or uncle). Importantly, these provisions expire after 2025.

QUALIFICATIONS TO CONSIDER

Along with the income limitations, there are other qualification requirements for claiming the child credit. As you might have noticed, a qualifying child must be under the age of 17 at the end of the tax year in question. But the child also must be a U.S. citizen, national or resident alien, and a dependent claimed on the parents' federal tax return who's their own legal son, daughter, stepchild, foster child or adoptee. (A qualifying child may also include a grandchild, niece or nephew.)

As a child gets older, other circumstances may affect a family's ability to claim the credit. For instance, the child needs to have lived with his or her parents for more than half of the tax year.

POWERFUL TOOL

Tax credits can serve as powerful tools to help you manage your tax liability. So if you may qualify for the child credit in 2017, or in years ahead, please contact our firm to discuss the full details of how to go about claiming it properly. ■

WHAT IS "REASONABLE COMPENSATION," ANYWAY?

The issue of reasonable owners' compensation often comes up in federal tax inquiries. But it may also be an issue in shareholder disputes and divorce cases.

For instance, minority shareholders or spouses of controlling shareholders may claim that an owner is taking an excessive salary, thereby impairing the value of the business. Alternatively, a nonowner-spouse may claim that a salary is too low, because the owner-spouse is trying to minimize the base on which alimony and child support payments will be calculated.

If you find yourself embroiled in these situations or under fire from the IRS, a financial expert can help you support — or defend against — these claims.

FACTORS TO CONSIDER

What's considered reasonable in shareholder disputes or divorces may vary based on state law or legal precedent. A reasonable compensation assessment generally starts by looking outside the company at external market conditions and geographic location. Then, the analysis turns to internal factors, such as the company's size, financial performance and compensation programs. Finally, the individual's contributions to the company, including his or her responsibilities, skills, reputation and experience, are factored into the analysis, along with any personal guarantees from the owner.

An owner may sometimes warrant a salary that's higher or lower than what nonowner-employees receive for similar positions. For example, the U.S. Tax Court recently upheld a combined annual salary of more than $7.3 million for two owners of a large Arizona concrete contractor. That may seem like a lot of money, but the court ruled that the company's investors still received a reasonable return on investment after owners' salaries were paid. This type of analysis is known as the independent investor test.

COMPENSATION RESOURCES

Another type of analysis hinges on comparable salaries paid in arm's length compensation arrangements. Reliable compensation data for a particular industry or geographic market can be found in several public and private salary surveys. A few common examples include Willis Towers Watson's executive salary surveys, the Risk Management Association's Annual Statement Studies® and MicroBilt's Integra industry reports. An expert may also consult Economic Research Institute's quarterly salary surveys, the Conference Board's annual executive compensation reports and Dun & Bradstreet's Key Business Ratios on the Web.

Additional industry- or location-specific data can be obtained from salary surveys that break down the data by industry, market or size; industry trade associations and publications; and executive headhunters.

OUTSIDE EXPERTISE

Deciding what's reasonable for a business owner to receive as compensation can be subjective and sensitive. Our firm can serve as an expert or work with yours to research comparable market data and use it to come up with a defensible estimate. ■

TAX CALENDAR

April 17

- Besides being the last day to file (or extend) your 2017 personal return and pay any tax that is due, 2018 first quarter estimated tax payments for individuals, trusts and calendar-year corporations are due today. Also due are 2017 returns for trusts, calendar-year estates and C corporations, FinCEN Form 114 (*Report of Foreign Bank and Financial Accounts* [but an automatic extension applies to October 15]), and any final contribution you plan to make to an IRA or Education Savings Account for 2017. In addition, Simplified Employee Pension and Keogh contributions are due today if your return isn't being extended.

June 15

- Second quarter estimated tax payments for individuals, trusts and calendar-year corporations are due today.

THE NEW DEAL ON EMPLOYEE MEALS (AND ENTERTAINMENT)

Years and years ago, the notion of having a company cafeteria or regularly catered meals was generally feasible for only the biggest of businesses. But, more recently, employers providing meals to employees has become somewhat common for many midsize to large companies. A recent tax law change, however, may curtail the practice.

As you're likely aware, in late December 2017 Congress passed and the President signed the Tax Cuts and Jobs Act. The law will phase in a wide variety of changes to the way businesses calculate their tax liabilities — some beneficial, some detrimental. Revisions to the treatment of employee meals and entertainment expenses fall in the latter category.

Before the Tax Cuts and Jobs Act, taxpayers generally could deduct 50% of expenses for business-related meals and entertainment. But meals provided to an employee for the convenience of the employer on the employer's business premises were 100% deductible by the employer and tax-free to the recipient employee. Various other employer-provided fringe benefits were also deductible by the employer and tax-free to the recipient employee.

Under the new law, for amounts paid or incurred after December 31, 2017, deductions for business-related entertainment expenses are disallowed. Meal expenses incurred while traveling on business are still 50% deductible, but the 50% disallowance rule now also applies to meals provided via an on-premises cafeteria or otherwise on the employer's premises for the convenience of the employer. After 2025, the cost of meals provided through an on-premises cafeteria or otherwise on the employer's premises will be completely nondeductible.

If your business regularly provides meals to employees, let us assist you in anticipating the changing tax impact. ■