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MARCH 2020

TAX AUDITS

The number and nature of income tax return examinations by the Internal Revenue Service (IRS) continue to evolve. The IRS has released statistics on the filing of 2017 income tax returns indicating that 150,043,227 individual tax returns were filed. Only about .59 percent of these (892,187) were examined. The vast majority of examinations, 722,772, were "correspondence" audits (that is, handled by written notices and correspondence) and only 169,415 were "field" audits conducted in person by IRS agents.

As might be expected, the likelihood of audits was vastly higher for very high-income taxpayers reaching 6.6 percent, but averaging .59 percent overall. The IRS continues to select returns using their Discriminate Index Function (DIF) system. Each tax return filed is assigned by IRS computers a DIF score based on the amount and kinds of income reported and the amount and kinds of deductions claimed. The higher the DIF score, the more likely the return is to be examined. Discrepancies between reported income and information returns (Forms 1099, Schedule K-1s, etc.) filed with the IRS also result in examination. There is also a random selection of returns. All returns received are assigned a random computer-generated number. After removing the returns selected for audit based on high DIF scores and for varying from information returns, a number of returns are randomly selected from the remaining pool.

Finally, some returns are selected as a result of information received from other sources on non-compliance with the tax laws or inaccurate filings. These sources include newspapers, public records, returns of other individuals, business partners, etc. Such information is evaluated prior to being used as a basis of an examination.

In summary, the IRS continues to select returns on several different bases but focuses on returns most likely to generate additional tax revenue. A taxpayer's potential for examination generally increases with higher levels of incomes, more deductions, and more complicated return issues. Accordingly, it makes good sense to produce adequate income and deduction records and to retain them for the appropriate amount of time.

REMINDERS

The beginning of spring affirms the fast approaching end of tax season and brings to mind, at least for tax accountants, the need for some related reminders and due dates.

Tax Return Data – Soon. Tax preparers inevitably benefit from and appreciate receiving as early as possible complete (or nearly complete) individual income tax data. Early receipt of all data (or all but a missing Schedule K-1, etc.) allows time for more thoughtful preparation and diminishes the hazards of a rush to completion during the last days of the season. Many taxpayers with complex returns, brokerage accounts with histories of

(Continued on reverse)

corrected information forms, late K-1s, etc. will be well served by an automatic extension of time to file until October 15. Extensions of time to file do not, in our experience, prejudice returns in any way. An automatic extension, however, does not extend the time to pay. Accordingly, early submission of the data for the computation of an estimated amount to be paid, if any, with the automatic extension will be helpful. For most individual income tax returns, the furnishing of all or almost all of the data by March 15 will allow the orderly preparation of a well-considered return. In instances where almost all of the data is not available by mid-March and for most very complex returns, automatic extensions of time to file are often the best choice.

IRA and HSA Contributions – April 15, 2020. Taxpayers making contributions to an individual retirement account (Roth IRA and traditional IRA) or to health savings accounts (HSA) for 2019 and who have not already done so will need to make the contributions on or before April 15, 2020. April 15, 2020 is the last available date for a 2019 contribution even if the taxpayer obtains an extension of time to file the 2019 individual income tax return.

The maximum contribution to an IRA (Roth or traditional) for 2019 is $6,000 for those below age 50 and $7,000 for those age 50 or above at December 31, 2019. We, of course, encourage early contributions to tax-deferred accounts for those certain of their eligibility. For 2020, the maximum IRA contributions are unchanged.

The maximum HSA contribution for a single person for 2019 is $3,500 and for a family is $7,000. The maximum 2020 contribution for a single person is $3,550 and for a family is $7,100. Taxpayers 55 and over can add $1,000 to their limits. Taxpayers who do not have an HSA (Medicare enrollees are ineligible) but want to consider them may want to read a brief article from our May 2019 newsletter available at www.cepcpa.com/resources/newsletters. A comprehensive description of Health Savings Accounts is included in IRS Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans available at www.irs.gov/publications/p969.

Charitable Contribution Receipts – Return Due Date. Taxpayers with 2019 charitable contributions will want to be sure to obtain properly worded receipts for contributions of $250 or more before the due date of their federal return. The written acknowledgement must state whether the organization provided any goods or services in consideration for the contribution.

Qualified Plan Distribution – April 1, 2020. Participants in qualified retirement plans, tax-sheltered annuities, or IRAs (other than Roth IRAs) are, under the new 2020 rules, generally required to begin withdrawals of minimum annual amounts from the plan by April 1 following the year in which they reach the required distribution age, 72. However, those reaching 70½ during 2019 (born prior to July 1, 1949) are under the old rules and must begin required distributions by April 1, 2020. The required minimum distribution rule generally applies to all such tax-favored plans. However, for most plans, individuals who reach age 72, are still employed at December 31, 2020, and are not five percent owners of their employer are not required to begin receiving distributions from their employer's qualified plan until April 1 following the year in which they terminate employment. Continued employment does not affect required distributions from traditional IRA accounts.

Although the first required distribution may be deferred until April 1 of the year following the year of reaching the required distribution age, it is likely that the distribution should be taken without deferral to avoid taxing two years' distributions in one year, possibly causing the recipient to be in a higher tax bracket or becoming subject to the Obamacare 3.8 percent add-on tax and increased phase-outs of deductions, credits, etc.

Distributions are not required from Roth IRAs until 10 years after the date of death of the owner. Generally, however, the entire account balance must be distributed before the tenth anniversary of the owner's date of death.

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Tax & Business Alert

MARCH 2020

GIG WORKERS, KNOW YOUR TAX RESPONSIBILITIES

Let's say you drive for a ride-sharing app, deliver groceries ordered online or perform freelance home repairs booked via a mobile device. If you do one of these jobs or myriad others, you're a gig worker — part of a growing segment of the economy.

In fact, a 2019 IRS report found that the share of the workforce with income from alternative, nonemployee work arrangements grew by 1.9 percentage points from 2000 to 2016. (That's a big increase.) And, over 50% of this rise occurred during the period 2013 to 2016, almost entirely because of gigs set up online.

A DIFFERENT WAY

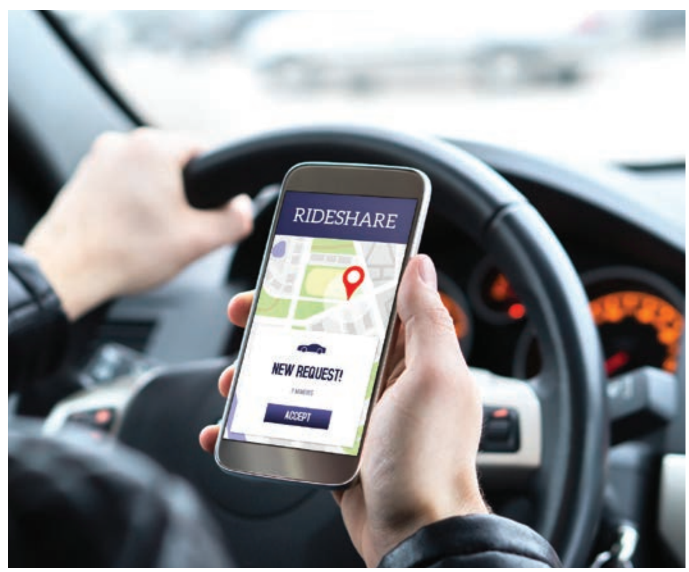
No matter what the job or app, all gig workers have one thing in common: taxes. But the way you'll pay taxes differs from the way you would as an employee.

To start, you're typically considered self-employed. As a result, and because an employer isn't withholding money from your paycheck to cover your tax obligations, you're responsible for making federal income tax payments. Depending on where you live, you also may have to pay state income tax.

QUARTERLY TAX PAYMENTS

The U.S. tax system is considered "pay as you go." Self-employed individuals typically pay both federal income tax and self-employment taxes four times during the year: generally on April 15, June 15, and September 15 of the current year, and January 15 of the following year.

If you don't pay enough over these four installments to cover the required amount for the year, you may be subject to penalties. To minimize the risk of penalties, you must generally pay either 90% of the tax you'll owe for the current year or the same amount you paid the previous year.



THE 1099

You may have encountered the term "the 1099 economy" or been called a "1099 worker." This is because, as a self-employed person, you won't get a W-2 from an employer. You may, however, receive a Form 1099-MISC from any client or customer that paid you at least $600 throughout the year. The client sends the same

EXPENSE DEDUCTIONS

By definition, gig workers are self-employed. So, your taxes are based on the profits left after you deduct business-related expenses from your revenue. Expenses can include payment processing fees, your investment in office equipment and specific costs required to provide your service. Remember, if you use a portion of your home for work space, you may be able to deduct the pro rata share of some home-related expenses.

form to the IRS, so it pays to monitor the 1099s you receive and verify that the amounts match your records.

If a client (say, a ride-sharing app) uses a third-party payment system, you might receive a Form 1099-K. Even if you didn't earn enough from a client to receive a 1099, or you're not sent a 1099-K, you're still responsible for reporting the income you were paid. Keep in mind that typically you're taxed on income when received, not when you send a request for payment.

GOOD RECORD KEEPING

As a gig worker, you need to keep accurate, timely records of your revenue and expenses so you pay the taxes you owe — but no more. Our firm can help you set up a good record keeping system, file your taxes and stay updated on new developments in the gig economy. ■

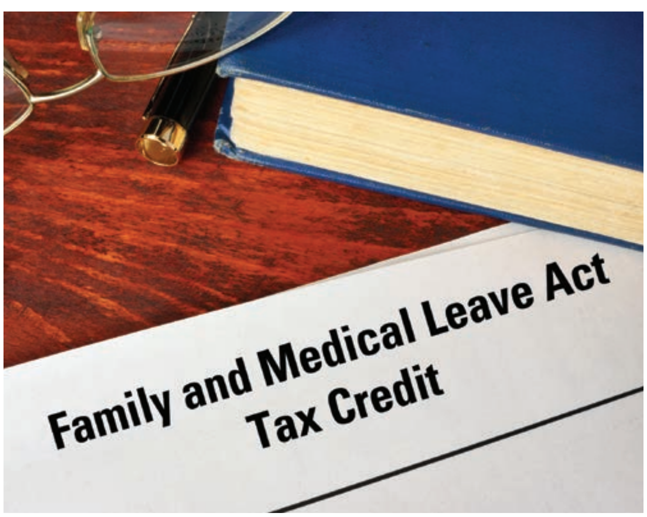
IS THE FAMILY AND MEDICAL LEAVE ACT CREDIT RIGHT FOR YOUR BUSINESS?

The Tax Cuts and Jobs Act created a new tax credit for certain employers that provide paid family and medical leave. Originally, it was available only for the 2018 and 2019 tax years.

However, in December, a new law extended the credit through 2020 for eligible employers that have a written policy providing at least two weeks of such leave annually to all qualifying employees, both full- and part-time, and meet certain other requirements.

THE CREDIT'S VALUE

An eligible employer can claim a credit equal to 12.5% of wages paid to qualifying employees who are on



family and medical leave, if the leave payments are at least 50% of the normal wages paid to them. For each 1% increase over 50%, the credit rate increases by 0.25%, up to a maximum credit rate of 25%.

An eligible employee is one who's worked for your company for at least one year, with compensation for the preceding year not exceeding 60% of the threshold for highly compensated employees for that year. For the 2019 tax year, the threshold for highly compensated employees is $125,000 (up from $120,000 for 2018). That means a qualifying employee's 2019 compensation can't exceed $72,000 (60% × $120,000).

Employers that claim the Family and Medical Leave Act credit must reduce their deductions for wages and salaries by the amount of the credit.

QUALIFYING LEAVE

Under the rules, family and medical leave is defined as time off taken by a qualified employee for only certain reasons. These include the birth, adoption or fostering of a child (and to care for the child). Care for a spouse, child or parent with a serious health condition qualifies, too, as does leave taken by an employee because of a serious health condition.

Also qualifying is any need because of an employee's spouse, child or parent being on covered active duty in the Armed Forces (or being notified of an impending call or order to covered active duty). Care for a spouse, child, parent or next of kin who's a covered veteran or member of the Armed Forces is eligible as well.

Employer-provided vacation, personal, medical or sick leave (other than leave defined above) is ineligible.

IMPORTANT DATE

Generally, to claim the credit for your company's first tax year that begins after December 31, 2017, your written family and medical leave policy must be in place before the paid leave for which the credit will be claimed is taken.

However, under a favorable transition rule for the first tax year beginning after December 31, 2017, your company's written leave policy (or an amendment to an existing policy) is considered to be in place as of the effective date of the policy (or amendment) rather than the later adoption date.

ATTRACTIVE BUT PRICEY

The new credit could be an attractive perk, but it can also be pricey because you must offer it to all qualifying full-time employees. Contact us for more info. ■

THE 2019 GIFT TAX RETURN DEADLINE IS ALMOST HERE, TOO

Most people have April 15 "tattooed on the brain" as the deadline for filing their federal income tax returns. What you may forget is that the *gift* tax return deadline is on the very same date. So, if you made large gifts to family members or heirs last year, it's important to determine whether you're required to file.

FILING REQUIREMENTS

Generally, you must file a gift tax return for 2019 if, during the tax year, you made gifts that exceeded the $15,000-per-recipient gift tax annual exclusion (other than to your U.S. citizen spouse) or that you wish to split with your spouse to take advantage of your combined $30,000 annual exclusion.

You also need to file if you made gifts to a Section 529 college savings plan and wish to accelerate up to five years' worth of annual exclusions ($75,000) into 2019. Other reasons to file include making gifts:

- That exceeded the $155,000 annual exclusion for gifts to a noncitizen spouse, or
- Of future interests (such as remainder interests in a trust) regardless of the amount, or
- Of jointly held or community property.

Keep in mind that you'll owe gift tax only to the extent an exclusion doesn't apply and you've used up your lifetime gift and estate tax exemption ($11.4 million for 2019). As you can see, some transfers require a return even if you don't owe tax.

NO RETURN REQUIRED

No gift tax return is required if your gifts for the year consist solely of gifts that are tax-free because they qualify as annual exclusion gifts, present interest gifts to a U.S. citizen spouse, educational or medical expenses paid directly to a school or health care provider, or political or charitable contributions.

But if you transferred hard-to-value property, such as artwork or interests in a family-owned business, consider filing a gift tax return even if you're not required to. Adequate disclosure of the transfer in a return triggers the statute of limitations, generally preventing the IRS from challenging your valuation more than three years after you file.

BE READY

If you owe gift tax, the payment deadline is indeed April 15 — regardless of whether you file for an extension (in which case you have until October 15 to file). If you're unsure whether you must (or should) file a 2019 gift tax return, contact us. ■

RAISING FINANCIALLY RESPONSIBLE KIDS

If you help your kids understand money when they're young, they're more likely to develop sound financial habits when they're adults. Of course, you'll want to tailor the information to your child's age. Here are some tips:

Toddlerhood and preschool. Talk about how most people work to earn money to buy things like food and toys. Bring your kids along on shopping trips and discuss how much various items cost. Point out that buying a more expensive item means less money for other things.

Early elementary school. Explain the difference between needs and wants. Provide a small "piggy bank." It might help if it's a clear container so kids can see their cash grow. Consider offering a small reward when the stash reaches a specific level.

Later elementary and middle school. Decide how you'll handle allowances. Some parents choose to remit an allowance only if certain chores are completed. Others provide it no matter what and discipline the child in other ways. Whatever your approach, teach your child to budget and have him or her set aside part of the allowance to introduce the concept of savings.

Middle school. Gradually increase your child's allowance. Suggest earning extra money through babysitting or other jobs.

High school. If possible, encourage your child to get a part-time job. Reinforce the importance of savings — whether for further education or some other goal. Discuss how to use credit wisely and how interest compounds over time.

Maintaining an open dialogue about finances and modeling sound money management can help you raise financially responsible kids. We'd be happy to provide additional ideas. ■