CPA

Client Bulletin

Smart tax, business and planning ideas from your Trusted Business Advisor[SM]

June 2019

In this issue

Mid-year tax planning

Year-end tax planning is on the agenda for many taxpayers, with good reason. That said, you don't have to wait for November or December to make astute moves. Planning in June or July can lead to tax savings that might be reduced or lost altogether if you wait for late fall to act.

Here are some areas to consider.

Retirement plan contributions

Go over scheduled salary reductions for contributions to 401(k)s and similar employer plans. Make sure to find out if any employer match is offered and, if so, that you'll be eligible for the full match.

Beyond matched contributions, consider unmatched contributions. The 2019 limit for 401(k) salary deferrals is $19,000 ($25,000 for those age 50 or older), so some or most of your contributions might be unmatched.

Example 1: Mona Newton, age 44, earns $100,000 at ABC Corp., which offers a 100% match on 6% of pay for its 401(k) participants. Mona has scheduled $1,000 a month in traditional 401(k) contributions, so the $6,000 she will have contributed through June will deliver $6,000 of employer contributions to her account: a 100% return on these contributions, with no investment risk.

Midway through the year, Mona can decide if she wants to continue her scheduled contributions. Does she want to increase them from a total of $12,000 for 2019 to as much as $19,000? Does she want to switch to a Roth 401(k) option going forward, if that's allowed in her employer's plan? That would mean Mona would pay more tax in the second half of 2019 but potentially build up an account that she eventually could tap, tax-free, in retirement.

Debt repayment

Paying down outstanding loans delivers a return equal to the interest rate. Therefore, paying down a credit card balance with interest rates of 12%, 15%, or more is often a savvy move.

In addition, paying down a loan without tax benefits is better than paying down a loan with tax-deductible interest. If you took the standard deduction for 2018 rather than itemizing your deductions, and likely will do the same in 2019, prepaying your home loan is a better deal. The same is true for student loan debt, if deducting the interest is not likely.

In addition, current tax law makes it more difficult to deduct interest on home equity

Matchless opportunities

Vanguard, a leader in managing defined contribution plan assets, has reported that 36% of participants do not contribute enough to get a full company match.

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loans and home equity lines of credit (HELOCs). If you're in that situation, prepaying a HELOC with a 6% interest rate is the same as earning 6%, after tax, with no investment risk, which may be appealing.

Roth IRA conversions

Under current law, income tax rates are generally lower than they were in 2017.

Example 2: Owen and Pam Rose have taxable income around $240,000, which puts them in the 24% tax bracket on their joint tax return in 2019. Two years ago, that same income would have put them in the 33% tax bracket.

After 2025, tax brackets are scheduled to return to the same rates as those effective in 2017. Keeping that in mind, the Roses may decide to convert some of their traditional IRA money to Roth IRAs. They might pay tax at 24% today and avoid future taxable withdrawals at 33%. After 5 years and after age 59½, all Roth IRA withdrawals may be untaxed.

However, current tax law also prohibits recharacterization (reversal) after a Roth IRA conversion. The amount that's converted will generate a tax bill for this year.

That's where mid-year planning can pay off. By this time, the Roses may have a good idea about whether their taxable income will be the same in 2019 as it was in 2018. If so, the Roses could be confident about the amount they'll move from their traditional IRAs to the Roth side.

With expected 2019 taxable income of $240,000, the Roses could convert $80,000 to a Roth IRA in 2019, staying within the 24% bracket. Such a conversion could cost $19,200 in tax (24% of $80,000), an outlay they believe would be worthwhile, possibly leading to tax-free cash flow in the future. Projecting year-end income at mid-year could lead to tax-effective moves from pre-tax to after-tax IRAs.

How IRAs affect Medicaid planning

The national median cost of a private room in a nursing home is $8,365 a month (over $100,000 a year), according to the 2018 Genworth Cost of Care Survey. Similar costs for assisted living and home health care are nearly $50,000 a year. Costs are higher in some areas, lower in others, but throughout the United States it can be very expensive to pay for any form of long-term care.

Insurance coverage is available, but not everyone (or their elderly loved ones) has this protection. Medicare offers limited coverage for long-term care. Consequently, many nursing home residents and others receiving custodial care rely on Medicaid to pay those bills.

Earning eligibility

Medicaid is designed for low-income individuals, so people with "too much" income won't qualify. The same is true for those with "too much" in assets.

The actual limits vary from state to state and differ if the applicant is single or married. Very generally, income must be lower than a few thousand dollars a month, and unmarried people must have less than a few thousand dollars in assets. Certain assets are exempt from the asset count, including a home and car.

Moreover, Medicaid rules aim to limit asset transfers that create questionable poverty. There generally is a five-year look-back period for tracking such transactions (in California, the look-back period is 30 months). Someone who applies for Medicaid within 5 years of an asset transfer will face a waiting period before Medicaid pays for long-term care.

With many people facing such requirements, some strategies have emerged to permit some asset preservation for those who need extensive and expensive care. Often, these plans involve placing assets in trust. Therefore, if you are interested in Medicaid funding for long-term care, you should consult with an experienced elder law attorney.

Avoiding the IRA trap

Individuals and couples who have done most of their saving in tax-favored retirement accounts face an added hurdle.

Example: Mark Harper, who was the family breadwinner, invested primarily in his company's 401(k) plan; he later rolled that money into a traditional IRA. After Mark's death, his widow Sue — the IRA beneficiary — has few assets outside of this tax-deferred account.

If Sue needs, say, $50,000 to pay for care now, she may have to withdraw $60,000 from the IRA to have the money she needs, after paying income tax. It's true that Sue might be able to claim her long-term care costs as an itemized medical deduction, but the addition to her adjusted gross income could wind up adding to her tax bill after all the numbers are crunched.

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Double trouble

If Sue needs long-term care and considers applying for Medicaid, two problems can arise. First, the IRA money may be counted as an asset by Medicaid authorities, putting Sue over the limit. Second, withdrawals from the IRA could put Sue over the monthly income ceiling.

Now for the good news. Some states consider a retirement account that's in pay-out status to be exempt assets, for Medicaid purposes. If Sue is 70**½** or older and taking required minimum distributions (RMDs) from her IRA, she might be able to exclude her assets from the Medicaid count. (Younger IRA owners may elect to take regular, periodic distributions based on life expectancy tables in order to claim pay-out status.)

However, RMDs from the IRA could put her over the state income limit for Medicaid eligibility, especially if Sue is receiving an ample amount from Social Security. If excess income is blocking a Medicaid application, creating an irrevocable qualified income trust may be a solution. Sue's IRA RMDs and her Social Security benefits might go into the trust, reducing her income but allowing Medicaid to pay for costly care.

Another possible tactic is for Sue to spend down her IRA, using the money for bucket-list travel and home repairs. The IRA money probably will be taxed at some point, but spending now will reduce the IRA balance and future RMDs, helping to reach Medicaid eligibility.

In addition, putting money into home improvements might raise the amounts passed to heirs. In 2019, depending on state law, home equity ranging upwards from $585,000 to a maximum of $878,000 may not affect Medicaid eligibility. (Connecticut, New Jersey, and New York are some of the states that have adopted this $878,000 limit; California has no home equity value limit). Again, working with a capable attorney might be required for such tactics to succeed.

New rules for business travel deductions

Business travel is still tax-deductible, under the Tax Cuts and Jobs Act of 2017 (TCJA), but there is a major difference now. Relatively few individuals will be able to claim such deductions; for the most part, deductions can be taken only at the company level.

How is this different from prior law? Before the TCJA took effect in 2018, people who itemized deductions could deduct miscellaneous itemized deductions that exceeded 2% of their adjusted gross income (AGI). Among the allowable miscellaneous deductions were unreimbursed employee business expenses.

Example: In 2017, Al Coleman was an employee of ABC Corp. He traveled extensively as part of his job, with no reimbursement from ABC. On his 2017 tax return, Al added up all his miscellaneous itemized deductions, including his business travel expenses, and deducted the amount over 2% of AGI.

Under the TCJA, miscellaneous itemized deductions no longer exist. No matter how much Al spends on business travel as an employee now, and how that compares with his AGI, there is no place on a tax return to deduct unreimbursed employee business expenses.

According to plan

Some individuals can still deduct business travel expenses. That includes self-employed individuals filing as sole proprietors and partners who are not reimbursed by their partnership. In those situations, business travel is another expense item determining annual profit or loss.

Conversely, if you are an employee, you may get no tax benefit from travel outlays that are not reimbursed by your employer. Your best tactic then would be to request reimbursement by your company — specifically under an accountable plan. (See **Trusted advice**.) Then,

you would get cash back without having to report taxable income, and the company would get a business deduction.

If a company's reimbursement plan is deemed non-accountable, the tax consequences can be severe. The amount reimbursed will be subject to income tax as well as payroll taxes, if applicable.

Entertainment eliminated

The other major change to the taxation of business travel under the TCJA is the elimination of deductions for business

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Trusted advice

Accountable plans

For an employer's reimbursement arrangement to be an accountable plan, it must meet the following requirements:

- Reimbursed expenses must have a business connection. The employee must have paid or incurred the expenses while performing services for the employer.
- The employee must adequately account to the employer for these business expenses within a reasonable amount of time.
- The employee must return any excess reimbursement or allowance within a reasonable period of time.

Other conditions may apply. Our office can help your company create and maintain an accountable plan.

entertainment. Whether you are at home or away, whether you're self-employed or on a company payroll, entertainment deductions have been abolished. You can still take clients or prospects to games, plays, and concerts, but no tax benefit will result.

Fortunately, a straightforward business meal is still deductible, in part. Meal deductions are 50% of the total cost, including beverages, tax, and tip. That's true whether you're picking up the tab for a meal with a business contact or just dropping by a diner for dinner while you're on the road.

Besides meals away from home, many other outlays can qualify as deductible business travel expenses. That includes air or rail travel, plus any limo charges for getting to and from an airport or railroad station. Other acceptable costs might be baggage charges, reasonable tips, and hotel bills if you're away from home with a valid purpose.

As has been true in the past, commuting to and from work is not considered deductible business travel. However, using your personal vehicle to make business calls can qualify for deductions. To calculate the amount, you generally can either track your actual costs or use a standard rate. In 2019, the standard mileage rate for the use of a car, van, pickup truck, or panel truck is 58 cents per business mile.

Tax calendar

JUNE 2019

June 17

Individuals. If you are not paying your 2019 income tax through withholding (or will not pay enough tax during the year that way), pay the second installment of your 2019 estimated tax.

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due for 2018. If you want additional time to file your return, file Form 4868 to obtain four additional months to file. Then, file Form 1040 by October 15.

Corporations. Deposit the second installment of estimated tax for 2019.

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in May if the monthly rule applies.

JULY 2019

July 15

Employers. For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in June if the monthly rule applies.

July 31

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2019. Deposit any undeposited tax. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the quarter in full and on time, you have until August 12 to file the return.

For federal unemployment tax, deposit the tax owed through June if more than $500.

If you maintain an employee benefit plan with a calendar year-end, file Form 5500 or 5500-EZ for calendar-year 2018.

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Citation and resource guide

Mid-year tax planning

The IRS explains the current tax treatment of interest paid on home equity debt at www.irs.gov/newsroom/interest-on-home-equity-loans-often-still-deductible-under-new-law.

How IRAs affect Medicaid planning

The federal government answers frequently asked questions about Medicaid at www.medicaid.gov/medicaid-and-you/index.html.

New rules for business travel deductions

The IRS lists the requirements for accountable plans in Publication 463, Travel, Gift, and Car Expenses, p. 29, at www.irs.gov/pub/irs-pdf/p463.pdf.

Practice development tip

Offer tax-efficient estate planning tactics

As you read on page 1 of this issue of the *CPA Client Bulletin*, June and July may be excellent months to offer mid-year tax-planning meetings. In order to further promote these meetings to clients, mention that you'll cover tax-efficient estate planning, as well.

Some clients might respond that the federal estate tax exemption is now $11.4 million per decedent, so this isn't a worry for them. It's true that *estate tax* planning won't be a concern for many people. On the other hand, you might point out that some estate planning practices can create *income tax* headaches for heirs.

To illustrate, suppose Ken Smith is a client with a large traditional IRA. He dies and leaves the IRA to his widow Lynn. Then Lynn dies, and a substantial IRA passes to the couple's son Mike and daughter Nancy.

Assume that Mike and Nancy are both in the 40s or 50s when they inherit shares of the IRA, with successful careers that place them in high income tax brackets. They'll have required minimum distributions (RMDs) on top of their other income, and who knows how high tax rates might be in the future?

To address this potential tax trap, you could ask clients if their estate plan includes charitable bequests. If so, you might suggest those charitable bequests come from traditional IRAs. The charities can get the money in the accounts without paying taxes, and your heirs could inherit more assets that don't come with future tax obligations.

Another approach is to suggest that clients skip charitable bequests or reduce them significantly. Instead, they could make qualified charitable distributions from their traditional IRAs to the recipient charities, as long as the IRA owners are at least age 70½. The charities would get the same money, only sooner, and beneficiaries could see taxable RMDs reduced or eliminated.

Indeed, some assets that pass to heirs might have unrealized capital gains. Under current law, those assets would get a basis step-up, possibly avoiding capital gains on a future sale by the heirs. Such planning could enhance your stature with clients because you would be suggesting ways to lower taxes on asset sales and IRA distributions for IRA owners and their beneficiaries.

Practice development and management resources from the AICPA

For more information or to order, log on to aicpastore.com or call 888.777.7077.

AICPA Personal Financial Planning Membership Section

The AICPA Personal Financial Planning Section membership is voluntary for CPAs and other professionals who provide personal financial planning services to individuals and families. The PFP Section member benefits include *The CPA's Guide to Financial and Estate Planning*, among numerous practice guides, as well as free web seminars led by renowned experts, award-winning newsletters like *Planner*, and invaluable networking opportunities with CPAs around the country.

[Item no. 03-NEW — AICPA Member $176.25]

Advanced Personal Financial Planning Conference — June 9–13, 2019

Any computer can collect data. What you can offer clients is something that far exceeds a machine. By building and expanding your consultation services, you'll be ready to meet future client needs and expectations. And you'll be ahead of changes in the profession that are just around the corner. The Advanced Personal Financial Planning Conference focuses on making you an invaluable voice in your clients' lives, starting today.

To learn about current deals, or if you have any questions, please call 888.777.7077 or visit www.aicpastore.com for more details.

AICPA PCPS/CPA.com MAP Survey National Summary

The AICPA's Private Companies Practice Section (PCPS) partnered with CPA.com on the National MAP (Management of an Accounting Practice) Survey, which was fielded from mid-May through July 2016. This summary provides financial and other key benchmarking data from the survey. This product will provide you with comparative benchmarking data relative to firm size and region that can help you create strategic goals and maximize your firm's performance.

[Item no. PCPSSUR03 — AICPA Member $200.00, Nonmember $300.00]

Management of an Accounting Practice eHandbook

This is your go-to resource for all things practice management. Streamlined online guidance for easy reading and quick reference on the topics you care about: employee compensation and benefits, staffing, disaster recovery, firm organization, benchmarking, strategic planning, and more!

[Item no. MAP-XX — AICPA Member $149.00, Nonmember $189.00]

MAP On Track

Often, practitioners and small- to medium-sized firms find it challenging to stay on top of firm management responsibilities. The new Management of an Accounting Practice On Track (MAP On Track) will help keep you organized. This new scheduler is easy to download and functions as an add-in to Microsoft Outlook, adding tasks to keep your firm running throughout the year. As an added bonus, within the automatically scheduled tasks you'll find useful links to relevant content within the comprehensive MAP eHandbook as well as PCPS tools that can inform your next steps.

[Item no. MAPTKD — AICPA Member $229.00, Nonmember $289.00]

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