Client Advisor

CURRENT INFORMATION, NEWS AND TRENDS

2019 FALL EDITION

Minimizing Tax on Social Security Benefits

Whether your Social Security benefits are taxable (and, if so, the amount that is taxed) depends on a number of issues. The following facts will help you understand the taxability of your Social Security benefits.

For this discussion, the term "Social Security benefits" refers to the gross amount of benefits you receive (i.e., the amount before reduction due to payments withheld for Medicare premiums). The tax treatment of Social Security benefits is the same whether the benefits are paid due to disability, retirement or reaching the eligibility age. Supplemental Security Income (SSI) benefits are not included in the computation because they are not taxable under any circumstances.

The amount of your Social Security benefits that are taxable (if any) depends on your total income and marital status.

- If Social Security is your only source of income, it is generally not taxable.
- On the other hand, if you have other significant income, as much as 85% of your Social Security benefits can be taxable.
- If you are married lived with your spouse at any time during the year, and file a separate return from your spouse using the married filing separately status, 85% of your Social Security benefits are taxable regardless of your income. This is to prevent married taxpayers who live together from filing separately, thereby reducing the income on each return and thus reducing the amount of Social Security income subject to tax.

The following quick computation can be done to determine if some of your benefits are taxable:

STEP 1. *First, add one-half of the total Social Security benefits you received to the total of your other income, including any tax-exempt interest and other exclusions from income.*

STEP 2. *Then, compare this total to the base amount used for your filing status. If the total is more than the base amount, some of your benefits may be taxable.*

The base amounts are:

- $32,000 for married couples filing jointly;
- $25,000 for single persons, heads of household, qualifying widows/widowers with dependent children, and married individuals filing separately who did not live with their spouses at any time during the year; and
- $0 for married persons filing separately who lived together during the year.

Where taxpayers can defer their "other" income from one year to another, such as by taking Individual Retirement Account (IRA) distributions, they may be able to plan their income so as to eliminate or minimize the tax on their Social Security benefits from one year to another. However, the required minimum distribution rules for IRAs and other retirement plans have to be taken into account.

Individuals who have substantial IRAs—and who either aren't required to make withdrawals or are making their post-age 70.5 required minimum distributions without withdrawing enough to reach the Social Security taxable threshold—may be missing an opportunity for some tax-free withdrawals. Everyone's circumstances are different, however, and what works for one may not work for another.

If you have questions about how these issues affect your specific situation, please give this office a call.

The purpose of this newsletter is to provide current information on tax, financial and business developments. It suggests general tax planning ideas that may only be appropriate when claiming tax benefits in a manner consistent with the statutes and Congressional purpose. The information and opinions are generalizations and may not apply to all taxpayers and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. Therefore, it is important that you seek appropriate advice before implementing any of the ideas suggested.

Contents:

» Minimizing Tax on Social Security Benefits 1

» Is It Time for a Payroll Tax Checkup? 2

» How to File Taxes after Saying "I Do" 2

» How to Organize Spending Priorities for Your Newer Growth Startup 3

» Tax Calendar 4

» Since You Asked 4

For any questions, please contact us. Our firm is here to help.

Hart & Associates
Oceanside, CA 92057
info@hartassoc-consulting.com
(888) 581-1020
hartassoc-consulting.com

Is It Time for a Payroll Tax Checkup?

Was your 2018 federal tax refund less than normal, or – worse yet – did you actually owe tax despite usually getting a refund? If so, this was primarily due to the last-minute passage of the Tax Cuts and Jobs Act at the end of 2017. Because the law was only passed late in the year, the IRS did not have adequate time to adjust its W-4 form and the related computation tables to account for all of the changes in the law. Thus, even if your taxes were lower for the year, the lack of adjustments to the W-4 and payroll-withholding tables meant that you likely had lower withholding and higher take-home pay for 2018. The bottom line is that, because your withholding was lower than it should have been, either your refund was lower than normal or you actually ended up owing money instead of getting a refund.

This situation surprised many taxpayers, some of whom faced financial hardships because they depended on their federal refunds to cover other expenses, such as home property taxes.

Throughout 2018, the IRS issued nearly weekly warnings that the W-4 form and its corresponding withholding tables did not properly account for the tax reform's changes, which caused the 2018 withholding amounts to be, in many cases, inappropriate. The problem was so widespread that Congress asked the IRS to waive underpayment penalties for taxpayers who ended up with a balance due but who had prepaid at least 80% of their 2018 tax liabilities. (Normally, taxpayers need to prepay 90% of their tax liabilities to avoid this penalty.)

Unfortunately, this problem will not be solved in time for the 2019 returns. Despite the problems in 2018, the IRS is waiting until 2020 to implement a new W-4 and to revise the accompanying computations so as to accommodate the tax reform's changes. As a result, the problem of insufficient withholding will persist for many taxpayers in 2019.

We are now over halfway through 2019, so it may be a good time to double-check your withholding and projected tax amounts in order to prevent another unpleasant surprise at tax time. If you are conversant with tax terminology, you can use the IRS's newly updated withholding estimator to do so. This online tool helps you to determine whether your employer is withholding the right amount of tax from your paychecks. However, be careful, as the results are only as good as the information that you put into the withholding estimator. You also have to estimate your income for the year from various sources.

Regarding the underpayment penalty, there are two points to consider. First, if you filed early in 2018 and you had tax due, then you may have paid an **underpayment penalty** because you hadn't prepaid enough tax through either withholding or estimated tax payments. As mentioned earlier, the IRS allowed a special exception to the underpayment penalty for those who prepaid at least 80% of their 2018 tax liabilities. However, it didn't establish the 80% penalty waiver until well into March, so those who filed early may have paid a penalty that they did not end up being liable for. To determine if you paid a penalty, look at line 23 of your 2018 Form 1040. If there is an amount on that line but you met the 80% minimum for the underpayment exception, you will be receiving a refund from the IRS. The IRS announced on August 14th that they will be automatically refunding the penalty to all qualifying taxpayers. There is no need to contact the IRS to apply for or request the waiver.

Second, **don't count on the IRS again lowering the underpayment penalty for this year**; it has given fair warning to taxpayers, who have had many months to review and adjust their tax withholding amounts. If you need to increase your 2019 withholding, you should do so soon; the end of the year will be here before you know it, and spreading out the adjustment over a longer period results in the least amount of pain in your budget.

If you are self-employed or otherwise pay an estimated tax, if you have a complicated return, or even if you would just prefer to have a professional perform your tax checkup, please give this office a call to make an appointment.

How to File Taxes after Saying "I Do"

A taxpayer's filing status for the year is based upon his or her marital status at the close of the tax year. Thus, if you get married on the last day of the tax year, you are treated as married for the entire year. The options for married couples are to file jointly or separately. Both statuses can result in surprises – some pleasant and some unpleasant – for individuals who previously filed as unmarried.

Individuals filing jointly must combine their incomes, and if both spouses are working, combining income can trigger a number of unpleasant surprises, as many tax benefits are eliminated or reduced for higher-income taxpayers. The following are some of the more frequently encountered issues created by higher incomes:

- Being pushed into a higher tax bracket
- Causing capital gains to be taxed at higher rates
- Reducing the child care credit
- Limiting the deductible IRA amount
- Triggering a tax on net investment income that only applies to higher-income taxpayers
- Causing Social Security income to be taxed
- Reducing the Earned Income Tax Credit
- Reducing or eliminating medical deductions

Filing separately generally will not alleviate the aforementioned issues because the tax code includes provisions to prevent married taxpayers from circumventing the loss of tax benefits that apply to jointly filing higher-income taxpayers by filing separately.

On the other hand, if only one spouse has income, filing jointly will generally result in a lower tax because of the lower joint tax brackets and a higher standard deduction, double the amount for single individuals ($24,400 for 2019), if the couple does not itemize deductions. In addition, some of the higher-income limitations that might have applied to an unmarried individual with the same amount of income may be reduced or eliminated on a joint return.

Filing as married but separate will generally result in a higher combined income tax for married taxpayers. For instance, if a couple files separately, the tax code requires both to itemize their deductions if either does so, meaning that if one itemizes, the other cannot take the standard deduction. Another example relates to how a married couple's Social Security (SS) benefits are taxed: on a joint return, none of the SS income is taxed until half of the SS benefits plus other income exceeds $32,000. On a married-but-separate return, and where the spouses have lived together at any time during the year, the taxable threshold is reduced to zero.

Aside from the amount of tax, another consideration that married couples need to be aware of when deciding on their filing status is that when married taxpayers file jointly, they become jointly and individually responsible (often referred to as "jointly and severally liable") for the tax and interest or penalty due on their returns. This is true even if they later divorce. When using the married-but-separate filing status, each spouse is only responsible for his or her own tax liability.

Once a couple files as married filing jointly they cannot undo that. However, if they file separately, they can later amend that filing status to married filing jointly.

Once the knot is already tied, the Social Security Administration should be notified of any name changes, and if they've moved, the IRS needs to be notified of the couple's new address.

If either or both of the newlyweds purchased their health insurance through a government marketplace, the marketplace should be advised of

Continue on page 3

How to File Taxes after Saying "I Do" (cont.)

the couple's marriage so that any advance premium tax credit (APTC) being applied to pay the insurance premiums can be adjusted when necessary. Doing so could prevent having to repay some or all of the APTC when filing their federal return(s) for the year of the marriage.

Of course the couple needs to notify their employers of their new marital status so any affected benefits can be updated. Usually new W-4 forms should be prepared and given to their employers so income tax withholding can be revised for the new filing status.

Other issues that may come into play and should be considered are:

- If one of the spouses has an outstanding liability with the IRS or state taxing authority, that situation could jeopardize any future refund on a jointly filed return.
- It may be appropriate not to commingle income from assets a spouse wants to maintain as separate property or where the spouses want to name separate beneficiaries.
- Individuals marrying later in life may wish to keep their incomes separate or only pay the tax on their own income.

If you have questions or would like an appointment to evaluate the impact of marriage on your tax liability before saying "I do," please give this office a call.

How to Organize Spending Priorities for Your Newer Growth Startup

According to a recent study conducted by U.S. Bank, over 80% of all newly formed businesses that ultimately fail do so due to cash flow problems. If you needed a reason to believe that getting your spending in order and dedicating the time to drafting a proper budget for your new startup is important, look no further than that one.

If you take the time to properly budget now, you're mitigating a significant portion of the risk you're likely to face in the not-too-distant future. If you don't, or worse—if you assume that you can just "make it up on the fly"—all you're doing is setting yourself up for disaster. Therefore, if you truly want to make sure that you have the budget you need to continue to build the business you've always wanted, there are a few key things to keep in mind.

IT BEGINS BY LOOKING INWARD, NOT OUTWARD

Maybe the most critically important thing for you to understand is that there is no "one size fits all" approach to creating a budget for your startup. Just as it's fair to say that nobody does what you do quite like how you do it, that same unique quality must extend into the world of budgeting for your SMB.

Every business is different – so while you can certainly look to some similar organizations for guidance and inspiration, be aware that their path is not one for you to rigidly follow. You need to start the process by taking a look at your long-term business goals – where are you today, and where do you want to be in a year or five years from now? What are the steps you need to take to help you accomplish that? What are the mile markers you'll need to hit along the way? Once you have the specific answers to these questions, then you can begin the process of figuring out what budget is most appropriate for your small business.

Once you contextualize everything through that lens, many of your priorities will easily reveal themselves. At that point, your job becomes making sure you're spending money in a way that supports those goals first, and everything else second.

As your budget starts to come together, you can even use it as an opportunity to learn more about the business and the way it operates. Once you can better identify how much money you have on hand and where it's going, you start to better understand things like:

- The actual money you're spending on labor and other materials necessary for your products and services.
- Your overall costs of operations.
- The level of revenue you'll need to generate to support your business moving forward.
- A realistic idea of how much money you can expect to make in terms of profit, and when.

So, as you work to come up with a budget that is more specific to your growth startup, you also begin to better understand how that startup works. At that point, you're not just in a position to make accurate, informed decisions about things like hiring or materials spending – you can also go back and reconfigure your budget to account for any trends or patterns that you've discovered. This cyclical process is also a great way to make sure that you always have the cash necessary to take advantage of opportunities as quickly as possible, even ones that you didn't necessarily expect.

THE "DAY ONE" BUDGET

For the sake of an example, let's say that you're planning a budget for a business that hasn't technically gotten off the ground yet. At that point, your priorities are a bit different as you're essentially trying to make "Day One" possible. Again, every business is going to be different from the next. But having said that, there are a few key things you will want to focus on to make sure that your opening goes as smoothly as possible:

- **Facilities costs** - Where, specifically, are you going to be doing business? Do you need to rent a storefront? Are you working out of a commercial office space? Will you need a warehouse or other logistical assets? Regardless of which one best describes your situation, you'll need to think about things like security deposits, any cosmetic or structural changes you need to make to the building, and even things like signage.
- **Fixed assets** - Also commonly referred to as "capital expenditures," these are the things that your people are going to need to do the jobs you've asked of them. This includes thinking about purchases like work vehicles (if applicable). You also have to buy furniture and other equipment like computers (after all, your people need a place to work).
- **Materials and supplies** - Costs in this category would refer to not only immediate needs like office supplies, but also those related to marketing and other promotional activities you might be engaged in. You're going to need a steady stream of all of these items to hit the ground running.
- **Miscellaneous** - These are all the other costs of physically opening a business that don't fall into the other three categories. You'll need to work with an attorney and likely a financial professional to make sure the back end of your business is in order. Depending on your industry, you may need things like licenses and permits—those cost money, too.

Remember: these aren't necessarily the costs associated with running your business in the long-term. These are just the things you'll need to take care of to make sure you're prepared to open your doors in the first place.

GET YOUR PRIORITIES IN ORDER

From a longer-term point of view, another key thing you'll need to do to organize your spending for your newer, growth-focused startup involves getting your priorities in order. Yes, expenses like those outlined here are going to remain important. But those are all about meeting short-term needs. To meet your long-term needs, you need to be judicious about where you spend your money and, more importantly, why.

For the best results, try to prioritize expenditures that actually generate revenue or some type of sizable return on investment in the future. If your startup depends on a particular piece of equipment in order to successfully churn out the product the company was founded on, it stands to reason that: A) buying that equipment and B) paying to maintain it and keep it in proper working order would be top priorities as you literally cannot function without it. The more products you can produce, the more you can sell—and thus the more revenue you can generate.

Go through all of your expenses and try to arrange things in order of importance. For the most part, the things that are absolutely necessary to avoid interrupting your business in any way are going to be at the top of your list.

As you move the order of certain budget items around, also be thoughtful of both the short- and long-term implications of that move. If you prioritize Factor A over Factor B, what chain of events could that cause? If you choose not to focus on computer maintenance and instead move funds elsewhere, what issues would that potentially cause? Are you in a business where slower or more outdated equipment would hurt productivity and your ability to serve your customers? Because if you are, that's a move you might want to re-think.

Yes, creating the right budget and organizing your spending priorities for your newer startup can feel complicated and time-consuming, but this is absolutely one of those situations where "getting it done" is less important than "getting it right."

If you feel as if you're having a hard time completing something this essential on your own, we can help. Not only can we help create a budget that supports your startup as it exists today, but we can also guarantee that you'll be ready for the business it becomes tomorrow, too.

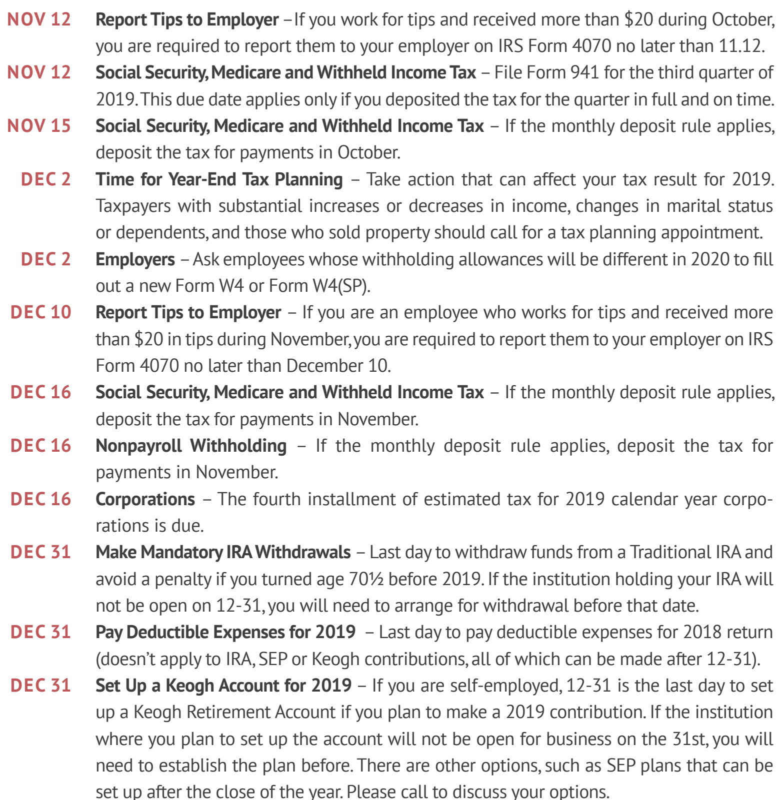
HART & ASSOCIATES

Hart & Associates
Oceanside, CA 92057

Client Advisor

2019 FALL EDITION

CURRENT INFORMATION, NEWS AND TRENDS



Tax Calendar

NOV 12 **Report Tips to Employer** – If you work for tips and received more than $20 during October, you are required to report them to your employer on IRS Form 4070 no later than 11.12.

NOV 12 **Social Security, Medicare and Withheld Income Tax** – File Form 941 for the third quarter of 2019. This due date applies only if you deposited the tax for the quarter in full and on time.

NOV 15 **Social Security, Medicare and Withheld Income Tax** – If the monthly deposit rule applies, deposit the tax for payments in October.

DEC 2 **Time for Year-End Tax Planning** – Take action that can affect your tax result for 2019. Taxpayers with substantial increases or decreases in income, changes in marital status or dependents, and those who sold property should call for a tax planning appointment.

DEC 2 **Employers** – Ask employees whose withholding allowances will be different in 2020 to fill out a new Form W4 or Form W4(SP).

DEC 10 **Report Tips to Employer** – If you are an employee who works for tips and received more than $20 in tips during November, you are required to report them to your employer on IRS Form 4070 no later than December 10.

DEC 16 **Social Security, Medicare and Withheld Income Tax** – If the monthly deposit rule applies, deposit the tax for payments in November.

DEC 16 **Nonpayroll Withholding** – If the monthly deposit rule applies, deposit the tax for payments in November.

DEC 16 **Corporations** – The fourth installment of estimated tax for 2019 calendar year corporations is due.

DEC 31 **Make Mandatory IRA Withdrawals** – Last day to withdraw funds from a Traditional IRA and avoid a penalty if you turned age 70½ before 2019. If the institution holding your IRA will not be open on 12-31, you will need to arrange for withdrawal before that date.

DEC 31 **Pay Deductible Expenses for 2019** – Last day to pay deductible expenses for 2018 return (doesn't apply to IRA, SEP or Keogh contributions, all of which can be made after 12-31).

DEC 31 **Set Up a Keogh Account for 2019** – If you are self-employed, 12-31 is the last day to set up a Keogh Retirement Account if you plan to make a 2019 contribution. If the institution where you plan to set up the account will not be open for business on the 31st, you will need to establish the plan before. There are other options, such as SEP plans that can be set up after the close of the year. Please call to discuss your options.

Since You Asked

YOU ASKED – My husband and I are getting a divorce and rather than sell the house I would like to keep the home. If I get a loan to buy out his interest in the home will the interest be deductible on my tax return?

ANSWER – Yes, IRS Notice 88-74 states that, in divorce situations, debt, secured by the home, incurred to buy out a former spouse's interest in their home is home acquisition debt. Therefore, interest on that debt is deductible as home mortgage acquisition debt interest up to the acquisition debt limits of $1 million for loans made before December 16, 2017 and $750,000 for loans made after December 15, 2017.

YOU ASKED– I purchased two plug-in electric Tesla vehicles in May, one for myself and one for my spouse. I know I get a $7,500 tax credit for one, but what about the second vehicle?

ANSWER – First of all, Tesla sales reached the point that the credit for a Tesla vehicle is being phased out. For a Tesla purchased in May of 2019 the credit is only $3,750, not the $7,500 you expected. The good news is you get a credit for both vehicles, thus your total credit will be $7,500.

YOU ASKED – I changed jobs this year and both employers have 401(k) plans. Does the maximum annual contribution for the year apply to each individual plan or to combined contributions to both plans?

ANSWER – The limits apply to the aggregated total, which for 2019 is $19,000 ($25,000 if you are age 50 or over). The limit not only applies to 401(k) plans but is also the annual total that can be contributed for any combination of 401(k), SEP IRA, SIMPLE and 403(b) annuity plans. Over-contributions must be corrected before the April 15, 2020 filing due date for 2019. Failure to make the correction will cause the excess to be taxable in 2019 and then again when it is ultimately withdrawn.