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2019 Tax Changes & Items to Note

It has been a constant struggle for the tax profession to keep up with how tax and accounting changes will affect our clients. My staff has attended over 70 hours each of continuing education each year for the past several years just to keep at the forefront of these changes (even though only 40 hours is required by the AICPA & none is required by the IRS as of 2015 due to their loss in the Supreme Court) to assure our clients receive the latest tax benefits and best advice. I have personally attended over 100 hours of continuing education courses each year for the past 14 years. Congressional changes to the tax code, especially the changes brought on by the December 2017 tax act, cause additional software and training expenses. As a taxpayer, you will notice the tax return itself looks dramatically different from its 2017 predecessor. Fortunately, we have always been able to alter our pricing structure to minimize the impact of such fee increases. One way we are able to accomplish this is by growing our tax return preparation business. Your continued help spreading the word to your friends, neighbors and local businesses about our hard work and willingness to go above and beyond for our clients helps us grow. It allows us to spread the additional costs across a larger client base thus minimizing the impact on any single individual's tax preparation fee. As we have grown, it has become increasingly difficult for me to meet personally with each client during the tax season. If you have specific questions or concerns that require a meeting to address them, I encourage you to schedule an appointment, otherwise you may write the question or concern on your organizer or request I give you a call to discuss and I will gladly respond via phone, text, email or as a note with your tax return. You are also welcome to ask one of my highly trained employees your question. They are able to answer most questions because of their many years working with me and attending most of the continuing education classes as I have. We are available year round, so anytime a question or concern arises outside of tax season, please feel free to contact us or schedule a meeting. **We greatly appreciate your support and thank you for your referrals.**

I try to be as thorough as possible in preparing my annual client tax organizer, but several years ago I already felt it was not enough to keep you updated so I created this annual booklet to bring some special items to your attention and to share some practical advice I have learned over the years.

As your accountant and advisor, I issue a warning to all clients looking to take advantage of tax credits and deductions. Even though a tax credit or deduction is available, you should always negotiate the lowest possible price and purchase items you will actually need and use. Economically, you need to make sure you aren't paying for more than you are receiving. The tax credit or deduction is just an extra bonus.

Last year's tax question was: "How will the Tax Cuts and Jobs Act affect me?". Fortunately, most of our clients did not have a negative experience as a result of the tax legislation changes. There were some major negative affects for certain clients employed in the construction and trucking industries.

The Act itself affects tax years beginning after January 1, 2018 with a few exceptions. Its provisions are currently set to expire in 2025, but from past experience I assume that to be unlikely as Congress has a history of changing provisions by extending, adding and deleting. We are still working with many rules and regulations created in the early 2000’s and late 1990’s which were originally supposed to expire over a decade ago.

Most taxpayers no longer qualify to itemize their deductions as a result of the Act’s increased standard deduction. That doesn’t mean taxpayers should stop tracking their medical, real estate tax, mortgage interest and charitable contributions. Many taxpayers will still be close to itemizing their deductions so a year where they incur unexpected medical expenses or a significant increase in charity could put them over the new standard deduction threshold. Also, many of those items qualify as deductions or credits on the Wisconsin income tax return.

The Act allows many deductions, credits and other tax items to be indexed for inflation in the future. However, this inflation index will be based on Chained CPI (C-CPI) rather than Consumer Price Index (CPI). Both numbers are measured by the Bureau of Labor Statistics and publicly available. **Consumer Price Index** measures the increase or decrease in cost of specific products over time. **Chained CPI** uses the same approach except it factors in the consumer tendency to substitute one product for a similar product if the cost of the original product increases significantly. The C-CPI effectively results in a lower rate of inflation calculation than the CPI over time.

INCOME AND DEDUCTIONS

Educator Expense and Tuition and Fees Deductions

The educator expense deduction has been extended permanently. The $250 per year amount will be indexed for inflation and allowable costs include the cost of continuing education courses. The eligible deduction for 2019 remains set at $250 because there wasn’t enough inflation to increase the deduction. The tuition and fees deduction ended with 2017.

Foreclosed or Abandoned Property

If you had a property foreclosed on or abandoned in 2019, let us know. There are many rules regarding the taxation and timing of these transactions. The qualified personal residence exclusion expired in 2016 however there are many other options still available that may allow you to exclude the cancelled debt from income. Many 1099-Cs are wrong. We need to know what the correct information should have been so we can correctly report it on your return. You must also provide us with all 1099-Cs received because some will come in duplicate from different institutions and be reported as such to the IRS. It is imperative that the tax return total match what the IRS shows to avoid an audit. We will take a deduction to reduce any over-reported amounts because many financial institutions will not correct the 1099-Cs.

Contribution Limit for 401(k) Plans
The maximum employee contribution is $19,000 in 2019 and $19,500 in 2020 for 401(k) and similar workplace retirement plans, including 403(b)s and the federal Thrift Savings Plan. Workers age 50 and older in 2020 can put in an additional $6,500 (the limit was $6,000 for 2019), making their maximum $25,000 for 2019 and $26,000 for 2020.

Contribution Limit for SIMPLE IRA Plans
The maximum SIMPLE IRA contribution is $13,000 in 2019 and $13,500 in 2020 with a $3,000 catch up available for taxpayers age 50 and older for both 2019 and 2020.

Contribution Limit for Individual Retirement Plans
The maximum Traditional and ROTH IRA contribution is $6,000 in 2019 and 2020. Taxpayers age 50 and older in 2019 and 2020 can put in an additional $1,000, making their maximum $7,000 in 2019 & 2020. You <u>must have earned income</u> to contribute to an IRA.

Track your ROTH IRA basis
The ROTH IRA can be a great retirement planning tool. Most individuals receive the greatest benefit by contributing at very young ages when their income is low because that is when they also pay the least or no tax on the money they have contributed. Unfortunately, because of the length of time the ROTH IRA is owned, it can be difficult to maintain the proper records to prove the amounts that were originally contributed. This would not be a problem if every taxpayer held the assets until beyond age 59 ½ before distributing. Sometimes a situation arises where it is necessary to take a distribution from a ROTH IRA before reaching age 59 ½. In this case, the taxpayer will be required to prove they have basis in the amount they withdrew to prevent the IRS from imposing tax and penalties on the withdrawal. Every investor who has a ROTH IRA should have a file for that IRA containing copies of checks paid for the contribution and copies of the brokerage statements proving the contributions were received and when they were received. You will also need to keep at least all the annual brokerage statements to prove funds were not previously withdrawn from the account or what funds were previously withdrawn to prove you have basis in your ROTH IRA. Many taxpayers rely on their brokers to track this information, but we have found if the time is necessary to prove the records, they simply don't exist. This is because of mergers and acquisitions of investment houses or taxpayer's movements of the funds between investment houses. According to the IRS, it is solely the taxpayer's responsibility to properly track their own basis; not the investment advisor, tax preparer or anyone else.

Required Minimum Distributions (RMD)
You are required to take Minimum Distributions from your IRAs in 2019 and 2020 if you became age 70 ½ or older before January 1, 2020. Make absolutely sure you did because the penalty is 50% of the RMD amount if you failed to do so. For taxpayers turning 70 ½ after December 31, 2019, the RMD age has changed to age 72 due to an law change passed in 2019.

For our clients who are over age 70 ½, I am pleased to report that Congress had made permanent the special tax provision that allows you to transfer charitable contributions directly from your IRA to your church or charity without a tax cost. The maximum amount that can be transferred on an annual basis is $100,000. **I recommend taxpayers collecting social security benefits use the direct transfer to charity rather than taking a distribution and then paying the money to charity.** That is because a distribution to the taxpayer is taxable income meaning the taxpayer will end up paying tax on their IRA distribution and additional tax on their Social Security benefits in exchange for a reduced charitable contribution deduction benefit, if any.

Stock Sales

Favorable capital gains rates will always be an area of contention in Congress especially when we have a deficit. However, we currently enjoy long term capital gain tax rates of 0%, 15%, 20%, 25%, 28% or 31.8%. In addition, larger capital gain sales can also trigger the Net Investment Income Tax of 3.8%. Fortunately most taxpayers will enjoy the 0% Federal rate. If you intend to sell a stock to trigger a taxable event, I must remind you that you may not re-purchase a stock that was sold at a loss for at least 30 days after the sale if you wish to deduct the loss. That rule does not apply to stock sold at a gain. So if you want to trigger a capital gain without losing any significant appreciation in a stock, you can sell a stock today and repurchase it tomorrow. Losses on stock sales are still limited to a maximum of $3,000 per year Federal and $500 per year WI for purposes of offsetting ordinary income. If you are sitting on stock profits at the end of the year you may want to consider selling those stock holdings before year end if you are carrying over capital losses from prior years especially if those losses are at risk of going unutilized.

Opportunity Zones

A new investment which allows for deferral of gains has been created with the 2018 tax law. An Opportunity Zone Fund allows investors to defer prior gains, similar to a like kind exchange, by reinvesting those gains into the fund. The fund then invests in businesses and property located in designated Opportunity Zones. The gains that were invested in the opportunity zone fund can be deferred until the earlier of when the investment in the opportunity zone fund is sold by the investor or 2026. The extent to which the deferred gain is taxed depends on the length of time it has been held in the opportunity zone fund prior to the date it was sold or 2026. The tax in 2026 is based on the lesser of the fair market value of the investment as of 2026 or the deferred gain. If the investment is held over 5 years but less than 7, 10% of the deferred gain is excluded from tax. If the investment is held over 7 years, 15% of the deferred gain is excluded from tax. If an investor holds the investment in the opportunity zone fund for ten years or more, the gain from the opportunity zone fund investment is tax free. Losses would be fully deductible as capital losses, only limited to the annual limits like all other capital losses.

Small Business Stock Sales

There is a special exclusion from income available for gains on the sale of certain small business stock for owners who have held the stock more than five years. This rule was originally created in 1993 and has had several modifications. As with all "to good to be true" tax loopholes, this exclusion has specific rules that must be met to qualify. The stock must have been acquired at original issue meaning only original owners will qualify. The company must be a C Corporation with less than $50 million in assets and engaged in an active trade or business.

If a taxpayer can satisfy those requirements, then the date the stock was acquired becomes a factor to determine the amount of gain that can be excluded and how any remaining gain is taxed. If the stock was purchased before February 18, 2009, 50% of the gain can be excluded with the remainder taxed at a flat 28%. If the stock was purchased between February 18, 2009 and September 27, 2010, up to 75% of the gain can be excluded with the remainder taxed at a flat 28%. If the stock was purchased after September 27, 2010, the greater of $10 million or ten times the taxpayer's basis in the stock can be excluded with the remainder taxed at a flat 28%.

This exclusion applies on a per company basis meaning a taxpayer could potentially have several companies that qualify for the exclusion. For example, Joe forms two C Corporations in 2011 which operate together as separate divisions of his overall business. In 2019, Joe sells the stock of the two companies for $11 million each to a competitor and decides to retire. Joe's basis is $1 million in Company A and $2 million in Company B. The stock sale of Company A is $1 million taxable at 28%. The stock sale of Company B is completely tax free. Of course, with proper planning, both company's stock sales could have been tax free had the purchase price been recognized differently between the two companies.

Sale of a Primary Residence or Secondary Home

Probably the single largest benefit for taxpayers is the exclusion of gain on the sale of a home. If a taxpayer has lived in a home for two out of the past five years, up to $250,000 of gain on the sale of the home can be excluded per taxpayer. There is an exception for property that was converted from a rental to a primary residence. The holding period is increased from two to five years in that case.

The original version of the TCJA proposed changing the requirement from two to five years and five to eight years but the proposed changes were axed during the final revisions allowing the home sale rules to remain unchanged.

Many times I am asked if the proceeds must be reinvested in a new home to exclude the gain. The answer is No. That idea comes from the rules prior to 1998. Before 1998, a home sale could be excluded only if the proceeds were reinvested in a new home. In 1998, the rules changed because Congress recognized many elderly taxpayers needed to downsize their home meaning, without a change to the rules, Grandma and Grandpa were going to be paying a lot of tax on the sale of their home.

Another common question is "Does the residence need to be separated from the rest of the land to exclude gain on the sale of the home?" A farm is a perfect example of this. Often they are part of 40, 80 or even 200 acres of adjacent land. Treasury Regulation 1.121-1(b)(3) states vacant land sold in connection with a home is considered part of the home sale as long as the land is adjacent to the land containing the dwelling unit of the taxpayers principal residence, the land was used by the taxpayer as part of the principal residence for at least two of the past five years and the land is sold within two years either before or after the sale date of the parcel containing the principal residence dwelling unit. This is slightly different than previous interpretations in that the land does not have to be sold to the same party as the home and the sales do not have to occur simultaneously. To be considered adjacent within the meaning of this rule is contiguous ownership with no parcels owned by something or someone other than the taxpayer in between. An LLC owned solely by the taxpayer and taxpayer's spouse is considered to be owned by the taxpayer for the purpose of this rule. Thus a 200 acre farm made up of five 40 acre parcels all connected to each other, but not all bordering the parcel containing the dwelling unit, can all qualify for the Sec 121 home sale exclusion even if the taxpayer sells them to various parties as long as all sales occur within two years before or after the date the parcel containing the principal dwelling unit is sold.

Own a Home or Rent Considerations

In recent years, many taxpayers have been taking a loss of the sale of their home. Unfortunately the rules treat this as a non-deductible personal loss and those rules are not expected to change. Initially this sounds horrible, especially when a taxpayer has lost \$30,000 or more. I use this example because in my case, I still live in my home which I purchased in 2009 and have over \$44,000 more invested in it (inclusive of real estate taxes) than I would probably get if I tried to sell it today. However, if I had rented at \$700/mo for those 10 years, it would have cost me over \$84,000 which I also would not have been able to deduct. So economically, I'm still ahead \$40,000 versus renting.
I have found the decision to buy versus rent a home has more to do with the area where the home is located and the length of time the buyer is planning to live in the home. In my opinion, if a buyer is planning to live in a home less than five years, he or she will likely be further ahead economically by renting whereas over five years could justify owning.

Life Insurance

Generally, life insurance proceeds are non-taxable when received by a beneficiary. When a life insurance policy is cashed out prematurely, there can be taxable gain from the appreciation of the cash value over the amount actually invested. Most times, it is better to take a loan from the life insurance policy or sell the policy to a beneficiary to keep it in force if the cash value is needed. Lately I've seen this issue arise in the case of individuals needing medical assistance. Many times, the policies are simply being cashed out losing the benefit of the appreciation because Medicaid is requiring the cash value. Serious consideration should be given to changing the ownership of life insurance policies in anticipation of nursing home and Medicaid planning to avoid losing the benefit of the life insurance itself.

Health Savings Account Contributions (HAS)

If you have an eligible High Deductible Health Plan (HDHP), the 2019 maximum contribution to an HSA is \$3,500 (\$3,550 for 2020) for Single and \$7,000 (\$7,100 for 2020) for Family. There is a \$1,000 per taxpayer catch up available for individuals age 55 & older. There is also a special once in a lifetime provision to transfer directly from your IRA to your HSA the amount of your maximum contribution tax free. HSA tax planning can be complicated and confusing but these are an excellent resource to utilize if you are covered by an HSA qualified HDHP. An important planning point to consider is in situations where the employer contributes some money toward your HSA but not the full amount to reach the limit. The employee is eligible to contribute the difference to their HSA account and deduct it on their tax return. To determine how much can be contributed to your HSA account for the calendar year, you need to consider how many months you were covered by an HSA qualified plan on the 1st day of the month and multiply that times your annual limit divided by twelve months. Contributions must be made by April 15th of the following year. Contributions in excess of the annual limit must be withdrawn by December 31st to avoid the 10% excise penalty.

Amounts in your HSA account can be carried over for use in the future unlike Sec 125 plans where the funds must be used currently or lost forever. This is important for those taxpayers who are looking for an option to save money to help them cover their retirement health care costs. HSA funds generally cannot be used to pay health insurance premiums however they can pay your Medicare part A, B & D and HMO but not Medigap premiums in retirement. They can also be used to pay COBRA insurance or health insurance while unemployed, long-term care expenses and up to a certain amount of long-term care insurance premiums. HSA funds can be used to pay medical expenses for anyone listed on the account owner’s tax return including their spouse and dependents.

For clients who are eligible to contribute to an HSA, we recommend maximizing the annual contribution. If you have to choose between maximizing the HSA or your traditional IRA, the HSA is potentially better because the HSA allows you a deduction of future medical costs which are likely to be non-deductible now that the standard deduction has been dramatically increased. If you don’t use the HSA for medical bills and withdraw funds for other purposes after age 59 ½, those funds are taxed just like an IRA withdrawal without penalty making the HSA contribution equivalent to a traditional IRA contribution.

Standard Deduction and Personal Exemptions

In 2018 Personal Exemptions were eliminated and the Standard Deduction was increased. For 2019 the standard deduction is $12,200 for Single taxpayers, $18,350 for Head of Household and $24,400 for Married Filing Joint taxpayers. An additional deduction of $1,650 for Single and Head of Household and $1,300 for Married Filing Joint is allowed for each taxpayer over 65 years of age.

Dependents and Non-Related Dependents

I am often asked who can be claimed as a dependent. In most cases the reason for the question is there is a dispute between two or more taxpayers over who has the right to claim the dependent. The biological parent who has documented proof the child spent more than ½ of the nights under his or her roof wins according to IRS Tax Court regardless of family court orders or child support payments, etc. as long as that parent has not released the claim to someone else using Form 8332. Of course, that’s the easy answer for most cases, but there are a plethora of scenarios that do not, at least initially, appear as clear cut.

For example: What about when both biological parents and their children are living with Grandma and Grandma can prove she is clearly the person who provides over ½ of the support for the household and the biological parents each had less than $4,150 income? If the biological parents do not file a tax return attempting to claim the children, the entire group qualifies as dependents of Grandma. Grandma should obtain a statement from the biological parents confirming they are releasing the exemption claim to Grandma for the children. There is no guarantee it will survive in tax court if the biological parents change their mind, but it can save Grandma from significant understatement penalties. This also applies if the grandkids live with Grandma, but the biological parents do not live with her. Grandma can still claim them all because the biological parents each had less than $4,150 income and did not file a return and did not claim the children themselves. What happens if one of the biological parents who earned $4,000 claimed the kids to get the child tax credit and earned income credit? Grandma loses! There's actually a very sad tax court case about exactly that situation.

What about when a Taxpayer has a non-related adult individual who had less than $4,150 of income and the Taxpayer can prove he or she has provided over ½ of that person's support? If the non-related adult individual does not file a tax return claiming him or her-self as a dependent, the Taxpayer can claim that person as a dependent.

What about married parents who have a single 23 year old child in college who lived away from home all year due to college, had $12,500 of income, and the parents can prove they provided over ½ of the child's support for the year? The parents can claim the child as their dependent if the child does not claim him or her-self as a dependent when he or she files his or her tax return.

What about married parents who have a 30 year old disabled child that does not file a tax return and lives in an apartment across town that the parents pay for along with over ½ of the child's support? The parents cannot claim the child as a dependent because the child lives in a separate residence and has gross income assumed to exceed $4,150 because a disabled child would normally be receiving Social Security benefits. There is an exception if the separate residence is a school, hospital, assisted living facility, nursing home, institution or incarceration facility. If that had been the case rather than just as apartment, the disabled child could have been considered a qualifying child so the $4,150 gross income limitation would not have applied, only the fact the parents provided over ½ of the support, thus allowing them the dependency claim.

Itemized Deduction Planning

Many people have heard it is possible to structure your itemized deductions to save taxes. What most people don't understand is how to do it correctly. Most taxpayers think just by itemizing they are saving taxes and they are correct. Itemizing does result in less tax when the itemized deductions exceed the standard deduction. To truly save taxes using an itemized deduction strategy, a taxpayer must have the unique circumstances to allow them to itemize their deductions every other year.

A typical example is a <u>Single</u> taxpayer has $4,000 mortgage interest, $3,200 Real Estate Taxes, $2,000 to Charity and $4,000 State Income Tax per year. That means his or her itemized deductions will total $13,200. The standard deduction is only $12,200. Thus he or she saves taxes on $1,000 each year. At 22%, that's $220 per year. So instead of only saving $440 every two years, the taxpayer changes his or her strategy. The taxpayer pays the real estate taxes every other year. So he or she deducts $3,800 over the standard deduction one year and the standard deduction in the next to get a "Free" $2,200 deduction in years he or she doesn't itemize. That's a gross tax savings of $1,320 over the two years. The taxpayer loses the WI credit every other year so the actual savings is only $1,020 which is still more than the $88 he or she would have saved by doing nothing differently.

The key to this example is the fact the taxpayer is Single. Married taxpayers are much less likely to qualify for itemizing even when doubling up expenses every other year simply because the standard deduction is $24,400 and the state and local tax (SALT) deduction is limited to $10,000 ($5,000 each for Married Filing Separately) regardless of how much the taxpayers actually spent.

There are ways to be even more aggressive such as structuring the payments to charity, mortgage and possibly withholding, but we would have to schedule a tax planning meeting to discuss those options in further detail.

The standard deduction changes made in 2018 eliminated an estimated 86% of itemized deduction filers, but as illustrated above, the law change does open doors to some taxpayers who could not have taken advantage of an itemized deduction strategy for additional tax saving.

I do issue a word of caution, as a result of the reduction in itemized deduction filers, the risk of correspondence audit greatly increases. That means taxpayers must make sure they have everything in their records to support the deductions. This goes specifically for medical and charity which are the areas the IRS will focus on in an audit. You will need proof of payment, receipts or statements showing no reimbursements were received or goods or services were provided in exchange for donations, invoices showing the taxpayer or dependent of the taxpayer were the recipient of medical services provided and paid for, HSA statements proving expenses that were or were not paid, etc.

Medical Expenses

The TCJA changed the AGI limitation on deductible medical expenses for 2017 and 2018 to 7.5%. After 2018 the limitation is restored to its pre-TCJA level of 10%. Thus 10% of a taxpayer’s AGI will constitute non-deductible medical expenses for 2019. Many taxpayers are confused how the deduction for medical expenses works. If for example a taxpayer’s income from all sources is $50,000 and the taxpayer has deductions for retirement plans of $5,000, the taxpayer’s AGI is assumed to be $45,000. The taxpayer has medical expenses of after tax health insurance premiums, co-payments for medical procedures and prescription drug costs of $7,000. Applying a 10% AGI limitation would mean $4,500 of the taxpayer’s medical deductions are non-deductible. Thus the taxpayer is only able to apply $2,500 of medical expenses toward the ability to itemize deductions.

State Income Taxes

The ability to deduct state, local, sales and real estate taxes has been changed by the TCJA. The total deduction for all combined taxes is capped at $10,000 for Single, Married Filing Joint and Head of Household filing statuses. The limit is $5,000 for a Married Filing Separate return. This will have the greatest impact on Married taxpayers whose combined tax payments are more likely to exceed that amount.

Sales Taxes

The ability to deduct sales taxes instead of income taxes for purposes of itemizing deductions has been permanently extended. This can benefit some Wisconsin residents who have none or little withheld for income taxes but is especially beneficial for residents in states where income taxes are nonexistent.

Real Estate Taxes

A common question is when the best time is or what is the best methodology for paying real estate taxes? An important consideration when paying real estate taxes is the up to $300 Wisconsin tax credit. It is based on the amount of real estate taxes paid in the current year. Therefore, if you are going to double up on real estate taxes to itemize deduct every other year you need to save at least $300 to justify the loss of the Wisconsin credit every other year.

After 2017 the State and Local Income Tax (SALT) deduction is limited to $10,000 so the strategy of doubling up on real estate taxes every other year may no longer be a successful strategy for taxpayers who benefited in the past.

For taxpayers who don't benefit from itemizing their deductions, I recommend for tax planning purposes paying the first installment in December rather than waiting until January and the remaining installments when due. Many taxpayers who escrow their real estate taxes through their mortgage payment are required by their lender to pay the real estate taxes in full each December when the bill is received or risk foreclosure.

Mortgage Interest

Recent IRS scrutiny of home mortgage interest deductions now require us to carefully track re-financings and the use of loan proceeds. Please provide us with any new home loan information, closing statements from any re-financings, and a summary of what any additional loan proceeds were used for. Specifically, they are looking at refinancing of the home mortgage to pay off credit card and other personal property loans such as vehicles. There are limits on the amount of mortgage interest that can be deducted in connection with these types of mortgages. The TCJA limits the mortgage interest deduction to being able to be claimed on only the first $750,000 of primary home mortgage debt. Home equity loan interest is not deductible for itemized deduction purposes after 2017 unless the taxpayer can prove the money was used for home improvements.

Mortgage Insurance (PMI)

After 2017 taxpayers who pay mortgage insurance will NOT be able to include the cost of premiums for itemized deduction purposes.

Charity

An IRS court case in 2008 reminds us of the rules on charitable contributions. ALL deductions of any amount must have a receipt. Any individual contribution over $250 must have an acknowledgement letter from the charity, and the letter must be dated prior to the date we file your return. The letter should show the date and amount of any individual contribution over $250, and should also state that **"no goods or services were received in return for the contribution"**. Basically the 2008 court case disallowed the deduction even though the taxpayer had all of the necessary documents because the letter from the charity was dated after the date the return was filed. In reality, this ruling will make any charitable contribution deduction difficult to defend in audit because of the maze of rules regarding what the letter must include. In addition to that, good luck trying to get a letter from large organizations like Goodwill in addition to the donation slip you received when you made the contribution. The IRS is aggressively enforcing these specific rules in audits that my fellow accountants are encountering nationwide. If you don't meet those specific rules your deduction will be disallowed in audit even though we know from a common sense standpoint the charitable contribution was made legitimately for that purpose.

Conservation Easements as Charitable Deductions
Conservation Easements have been scrutinized for many years and an area of contention in Congress. The charitable deduction of conservation easements has finally been settled and made permanent by this year's law. Conservation easement rules are complicated. Basically a taxpayer can deduct for charitable purposes the reduction in fair market value of property caused by the creation of an easement that restricts the use of the property for the purpose of preserving some unique quality the land possesses. Examples in Wisconsin include property that contains a natural lake, specific species of tree, kind of rock or unique rock formation, etc. An easement is generally expensive to draft because it has to satisfy the rules in order to be deductible.
Although a legitimate conservation easement can be a great way to plan to leave a future environmental legacy, the rules are ripe for abuse and many organizations have attempted to take advantage of this. Some have already gone to prison, so if an organizer contacts you with a conservation easement idea that sounds too good to be true, it probably is. The IRS is watching very closely and challenging many easements that appear to be mere tax shams.

Charitable Deduction to a Donor Advised Fund
With the increased standard deduction, many taxpayers will no longer be able to benefit from their charitable contributions. One way to increase a charitable deduction for a given tax year is to use a Donor Advised Fund. A taxpayer who consistently contributes to the same organizations year over year could place, for example, five years worth of donations in a Donor Advised Fund taking the charitable deduction in the year the funds were placed in the fund yet allow the donations to trickle out of the fund for the next five years to the various charities.

Retirement Plan Distributions directly to Charity
This is a repeat of what is mentioned in the **Required Minimum Distributions** section listed in this letter. For our clients who are over age 70 ½, there is a special tax provision that allows you to transfer charitable contributions directly from your IRA to your church or charity without a tax cost. The maximum amount that can be transferred on an annual basis is $100,000. **I recommend taxpayers collecting social security benefits use the direct transfer to charity rather than taking a distribution and then paying the money to charity.** That is because a distribution is taxable income so the taxpayer will end up paying tax on their IRA distribution and additional tax on their Social Security benefits in exchange for a reduced charitable contribution deduction benefit, if any.

CREDITS

Energy Credits

The most beneficial version of residential energy credits expired as of 2016. However solar water heaters, geothermal heat pumps, solar panel systems and wind turbines have a separate 30% credit available for their purchases and that credit will also be in effect until the end of 2019. This credit is non-refundable meaning it can only be used to the extent it offsets the actual tax liability for a given tax year.

Business owners looking to expand or make energy improvements to their buildings should contact us because there are still a variety of credits available beyond 2017. There are many limitations to these credits, so early warning will give us time to navigate the maze of rules to make sure your expansion or improvements qualify.

Energy Efficient Vehicle Related Credits

There is a credit available toward the purchase of a new fuel cell related vehicle through 2020. The credit varies according the type and weight of the vehicle purchased. According to the Department of Energy, there are many electric and hybrid vehicles that still qualify for the up to $8,000 tax credit. The opportunity to take this credit on certain electric cars is running out. It is projected Tesla, Chevy Volt, Chevy Bolt and Nissan Leaf no longer qualified for the credit sometime in 2019 as they exceeded 500,000 cars produced and sold.

Child Tax Credit (CTC)

This credit is now permanent unless Congress passes legislation to change it. For 2019, the amount is up to $2,000 per child. It is a refundable credit available to most parents whose earned income exceeds $2,500 and gross income from all sources does not exceed $200,000 for Single and Head of Household or $400,000 for Married Filing Joint. The refundable portion of the credit is up to $1,400 of the $2,000 total and is calculated as 15% of earned income exceeding $2,500. For example you must have at least $30,500 of earned income to receive the maximum credit for three children, just under $68,000 of earned income for seven children.

The CTC cannot be claimed by an individual for any years ended prior to the date their Social Security Number was issued. The IRS requires us to complete Form 8867 for taxpayers who claim the CTC. The Form is not necessarily difficult in itself to complete but the background compliance work imposed by the Form adds about $60 to the income tax preparation fee.

Flexible Non-Child Dependent Credit

Beginning in 2018 as part of the TCJA there is a new $500 credit for Other Dependents. Other Dependents are children over 17 years of age who no longer qualify for the Child Tax Credit, elderly or disabled dependents and dependents who have less than $4,150 of income (also see Dependents and Non-Related Dependents in this booklet for questions about a member of your household who had less than $4,150 of income). This credit was created to compensate for the loss of the personal exemption related to such dependents.

Earned Income Credit (EIC)
The earned income credit as modified back in 2009 is now a permanent change. This credit is available to married taxpayers with AGI up to $21,370 for no children, $46,884 for one child, $52,493 for two children, and $55,952 for three or more children. It is available to single taxpayers with AGI up to $15,570 for no children, $41,094 for one child, $46,703 for two children, and $50,162 for three or more children. The maximum credit is increased to $6,557 (for taxpayers with three or more children). Investment income cannot exceed $3,600. The EIC is one area where the marriage penalty can really take a bite out of your refund. So if you got married or plan to in 2019 and one or both of you were receiving EIC as part of your tax refund, you will need to adjust your withholding allowances on your W-4s so enough taxes are withheld to prevent you from coming up short at tax time.
EIC cannot be claimed by an individual for any years ended prior to the date their Social Security Number was issued.
The rules for EIC are becoming more restrictive due to fraud and identity theft. We will need additional documentation from you regarding your dependents that we use for EIC and the Child Tax Credit. The IRS now requires us to complete Form 8867 for taxpayers who claim EIC. The Form is not necessarily difficult in itself to complete but the background compliance work imposed by the Form will add about $50 to the future income tax preparation fee.
Due to fraud and identity theft, the IRS will be delaying EIC related refunds during the filing season. Unfortunately this delay will lead to an increase in predatory lending practices provided through many large income tax preparation services.
There will also be an increase in correspondence audits to verify taxpayers are maintaining proper documentation to prove their claims. If you receive a letter from the IRS or Wisconsin Department of Revenue, do not panic but do not delay complying with it. Typically the letter will ask for additional proof of your children such as confirmation letters from their school or medical provider.

Education Credits
The American Opportunity Credit and Lifetime Learning Credits include taxpayers up to $80,000 AGI Single, $160,000 AGI Married Filing Joint and is a refundable credit for individuals who do not have tax liability. These credits were made permanent in 2015. The maximum credit is $2,500 per student. A maximum of $1,000 is refundable. The credits have come under close scrutiny in recent years so make sure you get the Form 1098-T from the educational institution to prove the deduction. Education credits cannot be claimed by an individual for any years ended prior to the date their Social Security Number was issued. As is the case with CTC and EIC, the IRS who now requires us to complete Form 8867 for taxpayers who claim the American Opportunity Credit. The Form is not necessarily difficult in itself to complete but the background compliance work imposed by the Form will add about $50 to the future income tax preparation fee. The TCJA did make some changes to education related items but most items were allowed to remain the same as in the past. The Tuition and Fees deduction was eliminated under the TCJA. The exclusion for employer provided educational assistance remains intact. Employers can pay for up to $5,250 per year of each employee's education costs without including the benefit as taxable income of the employee. If an

employer pays for over $5,250 of an employee’s education costs in a year only the excess is taxable income to the employee.
The Student Loan Interest deduction remains the same for 2019 and 2020. Taxpayers can deduct up to $2,500 per year of student loan interest paid.

Farm Related Credits
Wisconsin discontinued the Dairyland Investment and Beginning Farmer and Farm Asset Owner Credits as of 2013. These credits were replaced by an Agricultural Credit. This credit is similar to the Domestic Production Deduction allowed by the Fed. It is based on the income generated from the production of tangible personal property produced on or from farmland you own or rent. This credit is going to be complicated to calculate, but worth doing the work. Insurance Proceeds, Rent Income, Custom Cropping Income, Patronage Dividends and several other income sources common to farmers are not considered qualified agricultural production income for purposes of this credit. The income must be derived from the property that is specifically classified as agricultural use (The property tax bill should show a special use factor in the assessed value section rather than specific dollar amounts). For 2016 and beyond the credit is 7.5% of qualified production income.

Manufacturing Related Credits
Wisconsin discontinued the Manufacturing Sales Tax Credit as of 2005. Since then, there hasn’t been much as far as tax advantages go for manufacturers in Wisconsin. That changed as of 2014. This credit is similar to the Domestic Production Deduction allowed by the Fed. It is based on the income generated from the lease, rental, license, sale, exchange or other disposition tangible personal property manufactured in whole or in part on property assessed as manufacturing by the manufacturing and Telco division of the Wisconsin Department of Revenue. This credit is going to be complicated to calculate, but worth doing the work. Real Property Construction is not considered manufacturing for purposes of this credit. For 2016 and beyond the credit is 7.5% of qualified production income.

Health Care Credit
Many individuals are divided regarding the Affordable Care Act and its ramifications. I am not interested in debating the political merits for purposes of this letter. What I am interested in is how the Health Care Credits work.
Basically if a taxpayer or taxpayer’s employer purchases insurance through the Health Care Exchange, the taxpayer might be eligible for a credit. The credit is based on the taxpayer’s household modified adjusted gross income and how it relates in terms of the Federal Poverty Level. Basically, if the household income based on tax returns filed by the taxpayer and others in the household is less than 400% of the Federal poverty level and the taxpayer paid health insurance premiums for insurance purchased through an exchange, the taxpayer will qualify for a premium tax credit. In real dollars, if a taxpayer with no children or spouse has household income less than $49,960, the taxpayer will probably qualify for a credit. For a married taxpayer with two children, the amount increases to $103,000. The amount of the credit is dependent on other factors such as the

level of coverage (Bronze, Silver, Gold or Platinum) and how much the taxpayer is actually paying out of pocket.

For taxpayers with health insurance, Form 1095s should be received containing valuable information we need to correctly complete the credit calculation forms.

For some individuals, the credit is going to be in excess of $10,000. Unfortunately, that opens the door for fraud.

Approximately 6% of taxpayers obtained insurance through an exchange in 2019. That means most returns will not be affected. Currently an estimated 20% of taxpayers qualify for insurance through the exchange but remain uninsured.

Penalties for individuals who are required to carry insurance under the ACA but do not have been repealed for 2019 and beyond.

ITEMS EFFECTING BUSINESS

Business Gross Receipts & WDOR Audits

As I have been saying for a long, long time regarding this issue, the Wisconsin Department of Revenue has been reconciling gross receipts on a business's Sales and Use Tax Returns to the total Sales reported on their income tax returns. Total Sales per the income tax returns should exactly match the total Gross Receipts reported for Sales Tax. The best way to survive an audit is to avoid it altogether.

Employee versus Subcontractor

Recently many more small business owners have been finding themselves in the subcontractor reclassified as employee pickle. Usually this happens when an individual the small business owner has been paying to do a task is no longer needed so the individual tries to claim unemployment.

There is a long list of items that can cause a subcontractor to be considered an employee and business owners should review their specific situation based on that list. However, I will give you a more sensible way to determine whether you have a subcontractor or an employee. The question is "Does the individual hold themselves out to the public as being in business and provide this service to other companies besides yours? If the answer is No, you probably have an employee.

What is the true cost of having an employee versus a subcontractor?

- You have to issue a 1099-MISC to a subcontractor you've paid over $600 in a calendar year. The subcontractor is responsible for the Social Security, Medicare and Income Taxes on the pay and it is not subject to unemployment tax. The cost of form and check processing is usually less than $50 in a calendar year.
- You have to issue a W-2 to an employee for all amounts you've paid to them in a calendar year regardless of amount. In addition, you have to pay Social Security, Medicare and Unemployment Taxes on the amount you've paid them. You can withhold half of the 15.3% worth of Social Security and Medicare Taxes from the employee's wages. You will have to pay for worker's compensation insurance. There are costs involved with calculating the paychecks and filing the payroll forms that can range from as little as $150 to as much as several thousand dollars in a year depending on the number of employees. Overall, I have found the cost of having an employee is on average 25% over the gross payroll amount.

What is the risk of treating an employee as a subcontractor?

In the case of a subcontractor reclassified as an employee, most of the time the employee is no longer on the payroll and the amount that should have been withheld is impossible to collect. Therefore, the employer is left with the full weight of the tax. In egregious cases, the government can hold the employer responsible for FICA, unemployment and income taxes that should have been withheld from the wages. Also, if workers compensation insurance was required, the employer will have to pay an especially high rate as a penalty for the wages not originally covered. Overall, the risk to an employer to have an employee they treat as a subcontractor can cost the employer more than two and a half times what they originally paid the subcontractor after the IRS, WDOR and DWD are done with taxes, interest, late fees and penalties.

Mileage Deductions

Deductible business mileage rate for 2019 is 58 cents/mi. (57.5 cents/mi. for 2020) and medical is 20 cents/mi for 2019 (17 cents/mi. for 2020). Charity has a fixed rate set by Congress of 14 cents/mi.

Repair versus Capital Improvement

A few years ago Fed Ex challenged the IRS in tax court over the definition of repair versus capital improvement and won. In response, the IRS (clearly dissatisfied) issued new regulations regarding repairs and capitalization. Those regulations went in effect in 2014. We will help you navigate the rules which can be complicated and confusing. In general the amounts set for repairs and maintenance versus capital improvements were initially set at $500 but starting in 2016 the threshold has been increased to $2,500 per invoice. Meaning any purchases or repairs under that amount can in theory be expensed and anything over that amount in theory must be capitalized and depreciated. I am in agreement with the rules as reasonable amounts to deduct.

The IRS could have stopped there and basically left us with a set of guidelines. However, they were not satisfied so they added another rule requiring an annual election to be made by small businesses to expense repairs and maintenance costs. This election requirement overcomplicated the rules for small businesses and the IRS has relaxed the rules surrounding that requirement in 2015.

It is my professional opinion that these IRS issued repair regulations, though reasonable overall, are outside of their legal authority because: 1) there has not been an Act of Congress approving any of these rules, and 2) these new rules are in direct conflict with 40 years of Tax Court rulings which are supported 100% by the Acts Congress has passed.

If small businesses make the election, it says they are agreeing with the IRS terms so even if these rules are defeated in Tax Court, small businesses who have made the election will be required to abide by them because of another rule that is totally enforceable by the IRS called “Adopting an Accounting Policy”. There are ways to comply with the rules without making the election.

Section 179 Expense Deduction & Bonus Depreciation

The Sec 179 deduction has been made permanent and will be indexed for inflation beginning in 2016. The limit has been set at $1,000,000 for 2018 with a phase out at $2.5 million. Air conditioning and heating units, software and retail leasehold improvements are eligible for Section 179 expensing. The first $15,000 of film and television production costs can also be immediately expensed.

Retail leasehold improvements are 15 year assets for depreciation purposes.

Bonus depreciation has been extended at 100% through 2022. After 2022 it will be 80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026 and then gone after 2026.

Parking Passes and Mass Transit

Employers could deduct the cost of transit passes and parking passes paid for employees without including as taxable income to the employee prior to TCJA. This employee benefit has been eliminated. Employers can provide the benefit, but the cost must be added to the employee's wages.

Uniformed Services Employees Wage Credit

This credit has been made permanent. It applies to employers who have active duty service members and is equal to 20% of wages paid while on active duty. As with all credits, proving the employee qualifies is complicated.

Work Opportunity Credit

The work opportunity credit is available through 2019. This is a credit equal to 40% of the first $6,000 of wages paid to an individual who has been unemployed for at least 27 weeks prior. As with all employment tax credits, the IRS has setup complex rules including the need for specific paperwork and documentation.

Energy Efficient New Home Credit

There is a credit available for manufacturers of energy efficient residential homes. A contractor may claim a credit of $1,000 or $2,000 for a home that meets certain criteria.

S-Corporation Built in Gains Tax

The lookback period for Built in Gains Tax has been permanently reduced to five years rather than the ten-year period in the past. The Built in Gains Tax applies to S-Corporations who were C-Corporations and had appreciated property and unrecognized income as a C-Corporation. It is a flat tax designed to capture the lost income tax on that unrecognized income if that income became recognizable within the lookback period. The TCJA reduced the highest Corporate tax rate from 39% to 21% meaning the built in gains tax has been reduced accordingly.

2018-2025 Corporate Tax Rate

The highest Corporate tax rate was reduced from 39% to 21% and the AMT for corporations was repealed. Prior to 2018 corporate tax rates were on a graduated structure as follows: 15%, 25%, 34%, 39%, 34%, 35%, 38% and 35%. If that order of numbers doesn't make sense to you, you are not alone and that is also what Congress was trying to address with the 2018 change. Instead of a myriad of rates and ranges Congress adopted a single flat tax rate of 21%. Contrary to popular media, not all corporations received a tax break. The flat tax actually increased the tax rate on small corporations with less than $50,000 net income from 15% to 21%.

20% Passthrough Business Income Deduction

A new concept designed by Congress in the TCJA includes a 20% deduction for income derived from business. Certain industries are excluded from taking advantage of the deduction if the taxpayer has more than $315,000 (MFJ) or $157,500 (Single) adjusted gross income. Businesses who can benefit will be able to exclude the lesser of 20% of their business net income or their taxable income from income tax. Business owners must pay self employment tax on 100% of the business net income. One concern already expressed by the IRS, and basically issued as a warning to business owners, is owners will reduce their wages to increase business income and take advantage of the 20% income exclusion. To address this issue, the IRS is going to step up reasonable compensation audits.

The Qualified Business Income Deduction applies to certain rental property as well as operating businesses. We will look at your rental activities and determine if they qualify for the extra deduction.

PLANNING INVOLVING CHILDREN

Planning for College

Four types of assets are excluded from the Federal Financial Aid Formula. They are: Retirement Plans, Home Equity in a Primary Residence, Annuities and Cash Value Life Insurance.

See my section on “Have your Child set up a ROTH IRA” for ideas on how that can be used for college saving.

Because Home Equity in a Primary Residence is an excluded asset, this should be considered when determining what forms of debt to pay off as your child nears college age. For example, a taxpayer owes $70,000 on a $200,000 FMV primary home at 4% interest. They have $10,000 in savings and want to use it to purchase a $30,000 vehicle. If the taxpayer borrows $20,000 for the vehicle and pays the rest from savings, financial aid will count the $10,000 equity as an asset. In contrast, if the taxpayer pays $10,000 toward the home mortgage and borrows $30,000 on the vehicle, financial aid will count $0 equity as an asset.

In my “Employing your Child” example, I encourage the children to have earned income. There is perhaps a more beneficial option to working for hourly wages that should be used in conjunction with the child’s part-time job. That is searching for scholarships. The child should reserve a couple of hours per week finding and applying for scholarships. There are many scholarships available that are fairly easy to be awarded but go unused because they are hard to find or apply for.

Education Savings Accounts

There are a couple of educational savings plan options available.

The Coverdell Education Savings Account allows a taxpayer to contribute up to $2,000 per year subject to income limitations. It is not a tax deductible contribution however the earnings grow tax free as long as they are used for education expenses. Distributions can be used to cover elementary, secondary and higher education costs.

The 529 plan is probably the most popular type of college savings plan our office sees. Like the Coverdell, contributions are not tax deductible and growth is tax free as long as distributions are used for education expenses. Distributions can be used to cover K-12 elementary, secondary and higher education costs at public, private and religious schools. There are technically no contribution limits to a 529 plan however there are rules and amounts to be aware of. Contributions to a 529 plan are considered a gift so a gift tax return is required for annual contributions exceeding $15,000 ($30,000 for married couples). There is a special election to skirt the annual gift tax limit that allows you to contribute $75,000 ($150,000 for married couples) at once but you cannot contribute more for at least five years. No one can contribute to a 529 plan after its value exceeds $500,000. Wisconsin allows up to a $3,000 per year tax deduction as long as the contribution is to a Wisconsin sponsored 529 plan.

Although the earnings grow tax free, it is very important that you keep track of your contributions to an education saving account in case you would have to prove them to the IRS or Wisconsin Department of Revenue. This issue can arise when claiming education credits in years where distributions were made from education savings accounts.

Employing Your Children

One tax saving strategy for small business owners is employing your children. There are rules to navigate such as needing a work permit for the child. Children can earn $12,200 (less other forms of income such as interest and dividends) tax free and another $9,700 at only 10% Federal income tax. The Wisconsin tax rate is 0% on the first $10,380 of income and averages roughly 8% on all income above that amount. For illustration, let's assume the owner's child is 16, has a work permit and is doing computer IT work for the business. The wages paid the child are $15,000 for the calendar year and Mom & Dad's income exceeds $120,000 putting them in the 22% tax bracket.

If the business is a sole proprietorship or LLC who reports on Form 1040 Schedule C: The child will pay $280 Federal Tax and $370 WI Tax. Mom and Dad save $3,048 Federal Income Tax, $1,240 WI Income Tax and $2,295 FICA Tax. That's a total net combined tax savings of $5,933.

If the business is a Partnership or S-corporation, the tax savings aren't as significant. The child will pay $280 Federal Tax, $370 WI tax and $1,148 FICA Tax. The owners of the business (assuming they're not just Mom and Dad) will pay $1,148 FICA Tax and possibly $553 Unemployment Tax at the business level. The owners will save $3,674 Federal Income Tax, $1,381 WI Income Tax and possibly $2,555 FICA Tax. That's a total net combined tax savings of $2,109 to $4,664. As you can see the savings for an incorporated business are not as significant, but can still be a benefit.

Have your Child set up a ROTH IRA

An individual can contribute the lesser of the amount of their earnings or $6,000 to a ROTH IRA in 2019 & $6,500 in 2020. That means, if your child has W-2 earnings in 2019 or 2020, he or she can start a ROTH IRA. Using my "Employing your children" example, this would allow the child to put money into a ROTH IRA nearly tax free and the earnings will be tax free as long as they wait until age 59 ½ to touch them. Another

neat benefit of a ROTH IRA is the principal can be drawn out at any time two years or more after starting the plan. I recommend leaving the money in as long as possible to allow the investment to grow tax free but there are situations where being able to touch the principal can be advantageous such as paying for College or purchasing a home. By using the ROTH IRA for college planning is it is not considered an asset for financial aid purposes unlike an education savings plan. For any of you who have or have had children in college, you understand how significant that is. Child assets carry a huge penalty for purposes of qualifying for financial aid.
A lot of taxpayers wonder how they are going to pay for their child's college expenses. Using the example from the section on "Employing your children" the child puts away $5,500 in a ROTH and the remaining $9,500 in a cash value life insurance policy or annuity. The parents can put the $5,933 tax savings away in a similar manner. That's $20,933 put toward college savings in one year and none of it is tied up for the exclusive use of college in case the child decides not to go to college. This illustration is to demonstrate how to put savings in funds not considered assets of the child for FASFA. You should do your research when purchasing any kind of insurance or annuity product because fees, charges, history of returns and surrender terms can vary greatly between them.

ESTATE AND GIFT TAX PLANNING

Gifts

The amount you may give to one person in one year without any gift tax return filing requirements is $15,000 for 2019 and 2020. This total includes the accumulated value of all gifts throughout the year to that one individual, so, if a monetary gift is given, I recommend it be for an amount less than $15,000. If you gift a house, property, stock, etc valued over $15,000, it is the responsibility of the grantor of the gift to file the gift tax return. The recipient is not responsible for any tax return filings or payments of any tax associated with the returns. If you have given a house or other property to anyone and not filed a gift tax return you should let us know so we can help you satisfy the mandatory filing requirements. Retaining a life estate reduces the value of the gift, but for most homestead gifts, the value is still greater than $15,000 thus requiring a gift tax return to be filed. Even if the gift is under the $15,000 annual exclusion, as long as there is a chance the value may be subjective, you should file a gift tax return so the three year statute of limitations the IRS has to challenge it starts. The IRS has instituted a Failure to File Penalty for Gift Tax returns of $195 per month per beneficiary further underscoring the saying "When in doubt, fill it out".

Estate Tax

The estate tax for 2019 will affect all deceased taxpayers who pass with over $11,400,000 in assets and life insurance in their estates on the date of death ($11,580,000 for 2020). For couples the limit is double at $22,800,000 ($23,160,000 for 2020). Most currently retired taxpayers will not be affected by the up to 40% rate "death tax" from a tax standpoint. Using current provisions, we recommend filing an estate tax return for every married taxpayer who passes away to take advantage of their lifetime exclusion and transfer any unused exclusion to their spouse. We can assist anyone who could be affected. With proper planning, estates much larger than the exemption amount should not pay any estate tax.

Probate

Although the estate tax will not affect most taxpayers, there is a common “death tax” that is usually overlooked that affects most taxpayers without proper planning. This “tax” is the probate fee that is charged to an estate based on the fair market value of your assets at the time of death. The fee is normally 3% of the gross value of the estate. Way to avoid the probate fee include: have your assets placed in a trust, gift the assets away before death, designate beneficiaries or place payable on death provisions on your accounts. You will need to work with an attorney to set up a trust. As with any estate planning strategy, every situation is different and needs to be dealt with based on all relevant facts and circumstances. We can assist you in the process.

OTHER RELATED ISSUES

Properly Completing a Form W-4

The IRS generally does a great job of creating forms based on the laws passed by Congress. Unfortunately Form W-4 is not one of them. It is one of the most confusing and most often incorrectly completed form the IRS produces. Being hired at a new job or having a life changing event such as marriage, divorce or passing of a spouse will result in a new Form W-4 needing to be completed. This year the TCJA forces us to recommend all of our clients revisit the Form W-4 they have on file with their employer. The elimination of personal exemptions and the creation of much larger standard deduction amounts could dramatically affect your taxes if the Form W-4 is completed improperly. A married couple whereby both spouses work and both spouses choose Married as their status of Form W-4 will theoretically under withhold on $24,000 of income on their 2018 payroll. If that couple is in the 22% bracket, they could be looking at a tax due of up to $5,280 rather than a refund.

To properly complete a W-4, I recommend ignoring the pages beyond page 1 completely. They will only serve to confuse you. To make things even more interesting, the IRS redesigned the W-4 for 2020.

Step 1 – Complete the name, address, social security number as directed on the Form.

(c) right below the address – If you are a Single individual choose “Single or Married Filing Separately” as your marital status. If you are Married it seems pretty straight forward that you should choose Married and that is where you could be very wrong. If you are Married and your spouse does not work or receive any type of income such as investments, unemployment, retirement or social security benefits you should be fine choosing Married as your status. If your spouse does work or has other income as listed above, you should choose “Single or Married Filing Separately”.

Skip Step 2.

Step 3 – If you want to ensure yourself of a refund put a zero in Box 3. If you are Single or Married but your spouse has income and you want to be close by having a small refund or small amount due, put the proper number of children in box 3 and calculate as instructed .

Step 4 – If you put zero in Box 3 in the step above to ensure a refund you could skip Step 4 if you have no other jobs or significant sources of income. If you have other jobs or significant income, you should put the total of that other expected income in box 4(a). In box 4(c) You can tell your employer to withhold an additional amount of income taxes from each of your paychecks if that is what you would like. This would work well if you don't want to tell your employer how much income you'll expect from other sources in box 4(a). Just leave 4(a) blank and have additional withholding taken out in box 4(c).
Final Step – Sign and Date the Form and turn it into your employer.

Underpayment of Estimated Taxes

Many individuals who are required to pay estimated taxes are required to do so because of a business they own, capital gain activities or pensions and IRA distributions are not withholding enough tax. It is usually difficult to predict the results of business operations when setting up quarterly estimated tax payments. The amounts are normally set based on the prior year of operations. A common problem is a sales lag or unexpected expenses pop up causing the business owner to decide not to pay or cannot pay that quarter's estimated tax payment. Later the business picks up and near year end the owner realizes they are going to owe taxes and an underpayment of estimated tax penalty. If the business owner has a spouse, this is one of several areas in which employing a spouse allows them to come to the rescue. A business owner can issue a bonus paycheck to the spouse and withhold enough in taxes to make up for the year's shortfall or more to reduce and possibly eliminate the underpayment penalty. Of course, the paycheck has to be issued in the calendar year, so tax planning is a necessity for business owners who want to make sure they are not paying more tax than required.

Ministers

The tax court case challenging the exemption of housing allowance from income has been overturned on appeal. Although this is good news for ministers for now, it is important to note the loss on appeal by opponents of the housing allowance exemption was based primarily on technical issues and therefore future challenges should be expected. Meanwhile the income exclusion has become increasingly more complex to track and prove so care should be taken in minister's record keeping to survive any challenges the IRS may bring in audit.

Foreign Accounts AND ASSETS!

The IRS is aggressively looking for offshore accounts and assets. If you have an account or asset worth over $10,000 in a foreign country, or a foreign business ownership (not through a mutual fund) please let us know as some special rules will apply to you. Failure to comply will result in hefty penalties (up to 50% of the value of the asset) so I need to know in order to help you keep the money and assets you worked so hard for.

Gas and Oil Investments

A popular trend in the past ten years or so was to invest in Gas and Oil related LLCs or Partnerships. These investments from a tax standpoint are fine as long as they aren't in your retirement plan. The problem that has been arising from owning these assets in retirement plans is the unrelated business income normally associated with these investments. If a retirement plan asset has unrelated business income and fails to file a 990-T, it disqualifies the entire IRA. This has been discovered recently by some of the brokerages and they are now filing the required documents. So how do you know if you might have a problem? If your K-1 has box 12 checked and box 20 contains a code V, you could have a problem. The next step is to call the broker and verify a 990-T was done for the retirement plan.

Fraud
The IRS has created Form 14242 you can use to report Tax Fraud.

Identity Theft
Many individuals are victims of identity theft and that number is growing rapidly. The criminals have the money, time and tools to steal your identity. Identities have been stolen from major corporate databases, credit card companies, shopping malls and some have even been stolen directly from the individuals through scare tactics or deception. The number one source listed by the FBI is now Social Media. There are programs thieves can use that will search based on name and develop a complete profile for someone based on the various things this person has posted about themselves on social media sites. 90% of Identity Theft victims are under age 25 or over age 65.
A common scam we've encountered this past year has been a phone call from the IRS claiming criminal prosecution if the taxpayer doesn't respond. Sometimes the caller is polite but usually they are forceful and rude. Do not call these numbers back or, if they do catch you when they call, hang up. We've turned many of these numbers over to the IRS for investigation. Unfortunately what we found out recently is the IRS doesn't have the resources or protocol to investigate. Before they look into a case, there must be many complaints about the same phone number over several months is the response received from the Milwaukee IRS office.
So how do you protect your identity and still be able to live life as you want to? The best way is to pay cash as often as you can. Be careful who you give your date of birth to. It's difficult to protect your social security number, address and bank information (it can be stolen off your checks). Avoid applying for new credit cards. If you have a card or two you've used for years, stick with them. If thieves aren't already doing so, eventually, these criminals will be sending out fake credit card applications to steal your identity. The Wisconsin Department of Revenue has expanded their identity theft identification program and prevented millions of dollars worth of fraudulently filed tax returns. If you receive a letter from them, please let us know immediately. Your refund will be held until you prove your identity. In 2018 the identity verification program again caught thousands of fraudulently filed tax returns and prevented the refunds from being issued.

Please remember to complete the dependents section of your organizers. IRS regulations require us to confirm dependents. Because of Identity Theft becoming such a large problem, we are also required to have picture ID (if possible) and Social Security Card copies on file for everyone listed on the return. We will also have clients complete a list of security questions and answers we can use to confirm identities if we receive a request to release your information.

Alternative Minimum Tax
TCJA originally proposed to end the AMT however during negotiations the AMT was allowed to remain a factor in tax calculations. The income level AMT begins to apply is $71,700 for Single taxpayers and $111,700 for Married Filing Joint taxpayers. The AMT is an alternative 26% to 28% "flat" tax assessed parallel to the regularly calculated income tax. If the AMT tax total exceeds the income tax calculated on the return, the taxpayer must pay the higher AMT amount. The AMT is not new. It was introduced in 1986 and merely modified throughout the past thirty or so years.

Penalties
The law imposes a $510 minimum penalty and additional 20% penalty for incorrectly reported EIC, CTC and Education Credit amounts. Taxpayers could also be barred from claiming EIC for up to ten years after an incorrect claim is filed. Preparers of an incorrect return will be assessed a $5,000 minimum penalty or 75% of the income from the tax return, whichever is greater. There are also hefty fines on preparers who do not complete what is referred to by the IRS as the Due Diligence requirements.

Signing Your Tax Return
To comply with current rules, we will need you to review the completed return we provide to you. Then you must sign your Form 8879 and return it to us within three business days after you sign it. If you can't, please let us know.

If You Expect to Need an additional Copy of Your Return Issued
Rules have become complicated regarding the release of client information. If you call us and verbally authorize release, we can no longer simply release the requested information or forward it on your behalf. We must have a Tax Information Disclosure Form signed from you authorizing release. So as a convenience to you, if you expect or suspect you may need a copy issued sometime this next year, please let us know so we can have you complete the proper paperwork while you are here at tax time.

Credit Score
What factors affect your Credit Score and to what degree to they affect it?
#1 – <u>Payment History</u> makes up about 35% of the Credit Score.
Late payments have a significant effect on credit score and remain on the credit report for 7 years.
#2 – <u>Revolving Utilization</u> makes up about 30% of the Credit Score.
The ratio of available credit to credit used has a significant effect on credit score. Even if a borrower pays off their balance every month the maximum balance accumulated in that month is the balance that will be used for the calculation.
#3 – <u>Length of Credit</u> makes up about 15% of the Credit Score.
The longer an account is open the better the effect is on the credit score. That is why it is considered better to keep an inactive or minimally active credit account open rather than closing it.
#4 – <u>Inquires</u> make up about 10% of the Credit Score.

The number of “hard” credit inquires made within the past 12 months affect the credit score. They are an indicator of a “need” for credit which can signal an increase in risk of debt not being repaid.

#5 – Total Accounts make up about 10% of the Credit Score.

There are two factors considered when looking at the total accounts open. The first being the total number of accounts open with long, clean credit histories have a positive effect on the credit score. The second being the mix of open accounts between installment loans and revolving credit accounts. A mix between accounts types has a positive effect on the credit score. Thus, a borrower with only revolving lines of credit such as credit cards will increase the credit score by financing a vehicle rather than purchasing it with cash.

Tax Rates Are Expected to Increase

Tax rates increased in 2013 and had been relatively stable though 2017, however the TCJA changed that. The tax rates under the TCJA actually dropped for most taxpayers under $150,000 of income. Those from the roughly $150,000 to $600,000 range of income unfortunately saw an increase in tax and individuals in the highest marginal bracket also saw a decrease. The national debt continues to grow but that growth in projected to slow dramatically (from 1.5 trillion per year to 1.5 trillion over the next ten years). Only time will tell if the projections are actually correct.

Efforts to cut spending will slow the bleeding but eventually our already accumulated debt needs to be repaid. To accomplish this there appears to be two directions Congress has been taking depending on who is in charge. One direction is to increase current tax rates, create new taxes and reduce credits and deductions. Congress is seemingly following a second direction. Using job creation to reduce spending on social programs and expand the taxpayer base to address the deficit. The indexing of brackets, etc to C-CPI rather than CPI also provides a gradual tax increase for every taxpayer over time being that taxpayer income will theoretically increase at a faster rate than the tax brackets, deductions, phase out limitations, etc. Doing the same job ten years from now with normal cost of living increases to your pay could land you in the 22% bracket when you are in the 12% bracket currently without a single change by Congress, besides extending the current law of course. Just like many of today’s senior citizens wondering why much of their social security benefit increase has been eaten up by the Medicare premium increase, workers will be wondering why their net paychecks aren’t increasing in proportion to their wage increase.

If you have no tax liability or a negative taxable income line on your tax return, we should be looking at your tax picture to make sure there is no future taxable income that you could be subjecting to tax now because of the low tax rate or no tax rather than into the future where higher taxes will likely exist. If you are still working and a retirement plan is available through your employer, you should be maximizing the benefit to take advantage of the employer match. Even if your employer does not offer a retirement plan, you should be investing in your own IRA. ROTH or Traditional will depend greatly on your current tax bracket and projected future tax picture. We can assist you with that tax planning.

CLOSING NOTE

There are literally hundreds of other changes, extensions and deletions of tax provisions that are too numerous to detail in this letter. We will consider all of the changes this year while preparing your return. Because the letter is much larger than I've produced in the past I am making it available via email, by request and physical copies at our offices in Shawano, Wittenberg and Wausau. Calculations are all for illustration purposes only and can differ based on individual circumstances. A comprehensive tax plan is always recommended for each individual and situation.

We are requesting everyone to try to have their tax information in to us as soon as possible and no later than March 31st if you want your return completed before the due date. Of course, extensions are always available if you need additional time to put your information together. An extension extends the due date to file the return but any tax due must be paid by the mid-April tax filing deadline to avoid penalty and interest charges. Contrary to popular belief, extensions actually reduce your audit risk because they give you additional time to gather the information necessary to file a complete and accurate return whereas many individuals who rush their filings estimate amounts and also tend to leave many deductions and credits unutilized. Please rest assured that we will utilize our best resources to once again provide you with timely, complete and accurate service while keeping your tax burden to the lowest legal amount.

Thank you for your continued support and for your benefit, we will continue to work as hard as we can to stay abreast of the changing taxes and economy.

We look forward to helping you again in the New Year. **We appreciate your business and referrals. We are accepting new clients, including businesses who are looking for bookkeeping, payroll, consulting, QuickBooks support, tax and/or other services. If you know of anyone we could help, please pass our information along to them. Thank You for your support!**

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