Quarterly Report

Summer 2018

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Manage Capital Gains Tax Tips

If not tracked and managed properly, capital gains tax can come as a large surprise at tax-filing time. In fact, many taxpayers do not realize they have a capital gain until they get their 1099 form in January and see a capital gain distribution. Here is what you need to know.

Understand capital gains and their taxability

Capital gains are recognized when you sell a capital asset for more than your basis in that asset. Capital assets are typically something of value like your home, a car and other investments. Basis is typically the original cost of the asset being sold. The difference between the sales price of the asset and your basis is the amount of the taxable capital gain.

The IRS taxes short-term capital gains for assets owned less than one year as ordinary income up to 37 percent, but taxes long-term capital gains at a maximum 23.8 percent (20 percent plus a potential 3.8 percent net investment tax).

Ways to manage capital gains tax

- **Hold investments for more than one year.** Long-term gains (assets sold more than a year after acquisition) are taxed at the lower capital gains rate. If you are able to hold assets for more than a year, you will save tax dollars by avoiding the gain being classified as ordinary income.
- **Sell large gains in low-income years.** If you expect lower income this year, it might be a good time to sell some of your capital gain investments. Since the capital gains tax brackets follow the marginal income tax brackets, if you are in a lower income tax bracket in a given year you may pay a lower capital gains tax. You can take advantage of this with both long-term and short-term gains.
- **Harvest large losses in high-income years.** If you have a high-income year you can save taxes by selling investments that have lost money. Capital losses help reduce your capital gains with the tax liability calculated on the net amount. Be aware of IRS netting rules that require you to net long-term losses with long-term gains and short-term losses with short-term gains. If one results in a net loss and the other a net gain, they are then netted against each other. If the final amount results in a net loss, the most you can deduct against ordinary income in one year is $3,000. The excess losses must then be carried forward to future tax years.
- **Gift your investments to your kids.** You are allowed to gift up to $15,000 per year to each of your kids ($30,000 per married couple). If you gift appreciated investments to a child under 19 and they then sell that investment, each child can receive favorable tax treatment on up to $2,100 from their taxes. Be careful if you go over the annual exemption. Higher levels of unearned income for children, including capital gains, is now subject to estate and trust tax rates.
- **Consider donating property.** If you donate appreciated property to a qualified charity you can deduct the donation as an itemized deduction. Even better, if the property is owned by you for more than one year, you can deduct the current market value without being subject to capital gain tax.
- **Sale of primary residence exclusion.** If you sell your home, you may qualify to exclude $250,000 of the gain from capital gains tax ($500,000 if married filing jointly). In order to qualify, you need to own the home and have occupied the home as your primary residence for at least two of the previous five years. The two years do not need to be simultaneous.

There are many factors that come into play when buying or selling an asset. Just make sure the tax implications are considered before you make the transaction.

As always, should you have any questions or concerns regarding your situation please feel free to contact us.

Perspective

An Inside View

Tom Giere

Dear Clients and Friends:

Summer is here again and as usual is going by way too quickly. The local county fair is in progress and many of the local festivals have already occurred or are upcoming in the weeks ahead. I hope you are enjoying this wonderful time of year with the leisure and recreation opportunities that it offers.

As I have for many years, I am again putting some miles on my bicycle this summer. Many of those miles are on the local bike trails. The Miami Valley region has a first-class trail system that allows for miles and miles of cycling away from automobile traffic, greatly enhancing the experience for cyclist at all levels of fitness and experience. Check out the trail system at https://www.miamivalleytrails.org/ or better yet, get out and ride!

On my summer reading list, this year was *Elon Musk, Tesla, SpaceX, and the Quest for a Fantastic Future*, by Ashlee Vance. The book is the story of Musk's life with an emphasis on the companies that he founded, Tesla, Inc. and Space Exploration Technologies Corp. doing business as SpaceX. Although the stories of both Tesla and SpaceX are still being written, one of my takeaways from the book was the value of thinking big. Both companies, that Musk is running simultaneously, are disruptors in their respective industries. The mission of Tesla is to revolutionize the automobile industry and SpaceX was founded to someday send a manned mission to Mars and colonize the red planet! Those are big thoughts!

My takeaway is that big thoughts can produce big change; big thoughts can produce great progress. We should all be open to big new thoughts and ideas. Sure, history tells us that only a handful of them will turn out, only a handful will produce meaningful results. But the ones that do, can help produce a fantastic future for all of us!

We hope you enjoy this issue of our *Quarterly Report*. We have included articles on managing capital gains, some changes in the sales tax area, and a new small business credit for medical leave. Let us know if you have any questions or need more information on these topics and please enjoy the rest of the summer!

Sincerely,

Tom

Student Loan Forgiveness Creates New Tax Trap

There is a new student loan repayment program that forgives some student loan debt if other payments are made. This new program is creating a tax surprise for the unsuspecting student. Here is what you need to know.

The debt forgiveness program dilemma

To combat the hardship of high student loan debt, a popular new repayment option is the income-based repayment plan. These plans limit monthly payments to a percentage of discretionary income. They also limit the number of repayment years. If your loan is not paid by a pre-determined future date and you have been making the payments as agreed, the balance of the loan is forgiven.

While the prospect of having a portion of the debt canceled is enticing, it can create an unexpected tax burden if you are not prepared. Here is why it may be a problem:

- **Canceled debt is considered taxable income.** When a portion of a loan is forgiven, that amount is considered taxable income in the year in which the debt is cancelled. While there are exceptions, this is the general tax rule.
- **A 1099-C is issued to you and the IRS.** Upon the forgiveness of the student loan debt, the loan servicing company will issue a Form 1099-C titled "Cancellation of Debt". A copy of the form will be delivered to both you and the IRS informing both parties of the amount of forgiven debt. This amount needs to be included on your Form 1040.
- **Taxes are due at filing.** The entire amount will likely be taxed at the taxpayer's highest marginal tax rate. This amount is due in its entirety at the annual tax-filing deadline. If a large amount is due, there may also be additional underpayment fees tacked on by the IRS.

Some exceptions apply

Before you begin to worry about a surprise tax bill, consider your other options:

- **Tax-exempt debt forgiveness programs:** There are a few programs that consider the student loan canceled debt tax-exempt. The two most common are for students that become public service employees and teachers. So when you have canceled debt, conduct a review to see if your employment complies with the possible tax exclusion.
- **Insolvency exclusion:** The IRS provides a way to exclude a forgiven debt from taxable income if you can prove you are financially insolvent. The IRS defines "insolvency" as when a taxpayer's total liabilities exceed his or her total assets. To claim this exclusion, an additional form is filed with your tax return. Make sure you can back up any claims you make, because the IRS may request to see proof.
- **IRS repayment plan:** If you have a balance due as a result of the canceled debt and cannot pay it in full by the deadline, the IRS has payment plans available. There will be additional penalties, interest and possibly setup fees that will be added to the amount due. This is not a great option, but it is better than not paying the balance at all.

Even with the additional tax liability that is realized, debt relief is generally a good deal for most. The hardship comes if you are not prepared for how to handle the tax payment that becomes due. Before signing an agreement that relieves debt, it makes sense to review your situation to avoid any surprises on your tax bill.

Business Solutions

Dramatic Sales Tax Change

The U.S. Supreme Court issued a ruling in the South Dakota vs Wayfair case that opens the door for states to impose sales tax on sellers outside their borders. The case highlights a new standard of business presence called "economic nexus" that may have major implications for businesses and consumers alike.

Economic nexus explained

The exact definition varies, but in general, economic nexus makes a connection between a taxing authority (usually a state) and a seller based on certain sales or transaction levels. The Supreme Court agrees with South Dakota that having economic presence is enough to require an out-of-state retailer to register with the state to collect and remit sales tax. For example, the state of South Dakota mandates that if a retailer has $100,000 in annual in-state sales or has 200 separate in-state sales transactions over the previous 12 months, they must collect sales tax on all sales in South Dakota.

What it means for businesses

- **New, lower threshold for tax exposure:** Sales tax nexus was mostly determined by physical presence. If a business has an office or employee located in a state, they likely were required to collect tax on sales in that state. The economic nexus standard removes the physical presence requirement with this ruling. Businesses now may need to compare sales-by-state data to the individual state economic nexus laws to determine whether they have a sales tax obligation in that state.
- **More tax registrations & filings:** Businesses that sell outside their state may need to register in many more states – maybe all 50. With more registrations come more compliance management and more sales tax returns that need to be filed on an ongoing basis. The impact on workload for sales tax staffs could be huge.
- **Increased audit potential:** With each new state registration comes a new potential audit authority. Sales tax audits almost always bring in additional revenue for states, so they will be looking to capitalize on the increased registrations. Sales tax compliance management is more important than ever and could lead to state income tax changes.

What's next?

As many as 16 states have economic nexus laws in place to try to take advantage of the new ruling, with many more to introduce legislation. By nature, Internet retailers will be hit the hardest and are expected to lobby in states that have not passed economic nexus laws. In addition, it will take states some time to get their systems updated to handle the new laws and increased filings. While there might be some short-term delays during implementation, sales tax changes appear to be on their way.

New! Small Business Medical Leave Credit

There is a new business tax credit that partially reimburses employers for providing paid family and medical leave for select employees. But small businesses should be informed before they try to use this new Family and Medical Leave Act (FMLA) tax break.

Basics of the new credit

Employers who provide at least two weeks of paid family and medical leave to employees who earn $72,000 a year or less can claim the FMLA credit to offset some of the cost of that paid leave. Some details:

- The credit ranges between 12.5 percent to 25 percent of the cost of the leave, depending on whether it pays 50 percent salary to a full salary.
- At least 50 percent of salary must be paid during the leave for employers to claim the credit.
- Employees must have worked for at least a year.
- Up to 12 weeks of leave are eligible for the credit.
- The $72,000 salary cap in 2018 will rise with inflation every year.

This credit comes as the result of a law requiring companies with 50 or more employees to provide up to 12 weeks of leave every year. The leave is intended to give employees time to address serious health issues, adapt to new additions to their families from births or adoptions, and to handle family military deployments.

However, small businesses with less than 50 employees are not covered by the FMLA, though they can voluntarily adopt a leave policy as an employee benefit and claim the new credit.

Considerations for small business owners

- The credit currently expires after the 2019 tax year. Congress' intention is to test adoption of the credit and later make it permanent if it is popular with employers.
- It requires administrative setup. You will have to draft a leave policy separate from your policies for regular vacation, personal, medical and sick time off.
- It may create an employee expectation. If you have not provided a paid leave benefit before but assess it is worth it due to the credit, it may be a letdown if the credit expires and you no longer offer the benefit to your employees.

Given the uncertain nature of the life of this new credit, if you plan to offer this benefit to your employees, please be prepared to know what you will do if the credit is not extended past next year.

As always, should you have any questions or concerns regarding your situation please feel free to call us.

Are you Sharing Too Much Information Online?

In today's digital age, it is impossible to avoid the Internet. Even if you do not have a computer and actively avoid social media, there is information about you in some corner of the web. Here are some tips to help you manage your digital footprint:

- **Actively manage your security settings.** Every app, social media site and web browser have multiple layers of privacy and security settings. When you download a new app or register with a new site, do not simply trust the default settings. Look through the options yourself to ensure you are comfortable with the level of privacy. One thing to watch for with apps on your phone is location settings. Some apps will track your location even when the app isn't running.

- **Protect your online image.** Career search firms now have strategies built entirely around recruiting through social media. According to LinkedIn, more than 20,000 companies use their platform to attract new talent. In addition to recruiting, human resource departments will vet prospective employees by reviewing social media profiles. What you share and how you portray yourself on social media is extremely important to your career. Pay attention to what others post about you, as well. If you are uncomfortable with what they are sharing, have a conversation with them and ask that it be taken down.

- **Set boundaries for yourself.** According to the Pew Research Center, 74 percent of Facebook users visit the site on a daily basis. And 51 percent say they visit multiple times per day. Try to find the balance that allows you to enjoy connecting with others online, but doesn't negatively impact other parts of your life. In addition to time spent, draw a bright line between what you consider shareable versus personal information. If you have these boundaries in mind when on social media, it will help you think critically before continuing to scroll or posting something.

- **Know your friends.** Having friends is fun. Having the wrong friends can be harmful and even dangerous. If you receive a friend request from someone you don't know, deny it. They might simply be trying to increase their friend count, but they could be looking to access personal data. Review your friends on every platform on a periodic basis, and don't fret about how many friends you have. Quality is much more important than quantity.

The best defense of your private information is you. Having a plan and actively managing your online profiles is the best way to minimize the chance of your personal data falling into the wrong hands.

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Firm Highlights

Thank you to the Miami County community along with all of our clients and friends for choosing us as "The Best" Accountant/CPA in the 2018 Readers' Choice Awards.

We will resume our normal Monday-Friday hours of 8:00 am to 5:00 pm beginning Tuesday, September 4, 2018.