CIRIMELLI, PYLE & ASSOCIATES LLP
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Online Advisor – May 2018

Major Tax Deadlines For May 2018

Note: Businesses are required to make federal tax deposits on dates determined by various factors that differ from business to business.

Payroll tax deposits: Employers generally must deposit Form 941 payroll taxes (income tax withheld from employees' pay and both the employer's and employees' share of FICA taxes) on either a monthly or semiweekly deposit schedule. There are exceptions if you owe $100,000 or more on any day during a deposit period, if you owe $2,500 or less for the calendar quarter, or if your estimated annual liability is $1,000 or less.

- Monthly depositors are required to deposit payroll taxes accumulated within a calendar month by the fifteenth of the following month.
- Semiweekly depositors generally must deposit payroll taxes on Wednesdays or Fridays, depending on when wages are paid.

For more information on tax deadlines that apply to you or your business, contact our office.

Update on the Tax Cuts and Jobs Act (TCJA)

The Tax Cuts and Jobs Act (TCJA) was passed by Congress in a hurry late last year, and the IRS and tax preparers have been working to digest some of the more thorny issues created by the tax overhaul. Here are the latest answers to some of the most common questions:

1. **Is home equity interest still deductible?**

The short answer is: Not unless you've used the money to buy, build or substantially improve your home.

Before the TCJA, homeowners were able to take out a home equity loan and spend it on things other than their residence, such as to pay off credit card debt or to finance large consumer purchases. Under the old tax code, they could deduct interest on up to $100,000 of such home equity debt.

The TCJA effectively writes the concept of home equity indebtedness out of the tax code. Now you can only deduct interest on “acquisition indebtedness,” meaning a loan secured by a qualified residence that is used to buy, build or substantially improve it. If you have taken out a home equity loan before 2018 and used it for any other purpose, interest on it is no longer deductible.

2. **I'm a small business owner. How do I use the new 20 percent qualified business expense deduction?**

Short answer: It’s complicated and you should get help.

Certain small businesses structured as sole proprietors, S corporations and partnerships can deduct up to 20 percent of their qualified business income. But that percentage can be reduced after your taxable income reaches $157,500 (or $315,000 as a married couple filing jointly).

The amount of the reduction depends partly on the amount of wages paid and property acquired by your business during the year. Another complicating factor is that certain service industries including health, law, consulting, athletics, financial services and accounting are treated slightly differently.

The IRS is expected to issue more clarification on how these rules are applied, such as when your business is a mix of one of those service industries and some other kind of business.

3. **What are the new rules about dependents and caregiving?**

There are a few things that have changed regarding dependents and caregiving:

- **Deductions.** Standard deductions are nearly doubled to $12,000 for single filers and $24,000 for married joint filers. The code still says dependents can claim a standard deduction limited to the greater of $1,050 or $350 plus unearned income.
- **Kiddie Tax.** Unearned income of children under age 19 (or 24 for full-time students) above a threshold of $2,100 is now taxed at a special.

- **Family credit.** If you have dependents who aren't children under age 17 (and thus eligible for the Child Tax Credit), you can now claim $500 for each qualified dependent member of your household for whom you provide more than half of their financial support.
- **Medical expenses.** You can now deduct medical expenses higher than 7.5 percent of your adjusted gross income. You can claim this for medical expenses you pay for a relative even if they aren't a dependent (i.e., they live outside your household) as long as you provide more than half of their financial support.

Stay tuned for more guidance from the IRS on the new tax laws, and reach out if you'd like to set up a tax planning consultation for your 2018 tax year.

Audit rates decline for 6th year in a row

(but don't get complacent)

IRS audit rates declined last year for the sixth year in a row and are at their lowest level since 2002, the agency reported. That's good news for people who don't like to be audited (which is everybody)!

But don't get complacent. A closer look at the IRS data reveals some audit pitfalls to beware. Here is what you need to know:

Audit rate statistics for individuals

Fiscal Year Ending	2017	2016
All individual tax returns	0.62%	0.70%
No income	2.55%	3.25%
Income under $25,000	0.71%	0.80%
$25,000 - $50,000	0.49%	0.49%
$50,000 - $75,000	0.48%	0.41%
$75,000 - $100,000	0.45%	0.52%
$100,000 - $200,000	0.47%	0.62%
$200,000 - $500,000	0.70%	1.01%
$500,000 - $1 million	1.56%	2.06%
$1 million - $5 million	3.52%	4.60%
$5 million - $10 million	7.95%	10.46%
$10 million and over	14.52%	18.79%

Note: These audit rates are stated as a percent of total tax returns with "total positive income" (TPI) as claimed on individual tax returns. In general the examinations are for tax returns filed in the previous calendar year.

Observations

- **Low statistics** for audit examinations obscure the reality that you may still have to deal with issues caught by the IRS's automated computer systems. These could be math or typo errors or missing forms. While not as daunting as a full audit, you need to keep your records handy to address any problems.
- **Average rates** are declining, but audit chances are still high on both ends of the income range: no-income and high-income taxpayers.
- **No-income taxpayers** are targets for audits because the IRS is cracking down on fraud in refundable credits designed to help those with low income, such as the Earned Income Tax Credit (EITC). The EITC can refund back more than a low-income taxpayer paid in, so scammers attempt to collect these refund credits through fraudulent returns.
- **High-income taxpayers** have increasingly been a target for IRS audits. Not only do wealthy taxpayers tend to have more complicated tax returns, but the vast majority of federal income tax revenue comes from wealthy taxpayers. Based on the statistics, the very highest income taxpayers can assume they will be audited about every six years.
- **Complicated returns** are more likely to be audited. Returns with large charitable deductions, withdrawals from retirement accounts or education savings plans, and small business expenses and deductions are reportedly more likely to be the subject of an audit.

Stay prepared

Though audit rates are declining, don't discount the possibility that you may still be selected randomly for an audit. Always retain your tax records and support documents for as long as you need them to substantiate claims on a return. The IRS normally has a window of three years from the filing date to audit a return, but this can be extended if the agency believes there's any fraudulent activity going on.

If you do receive an audit letter from the IRS, it's best to reach out for some professional assistance as soon as possible.

Get your small business off the rocks

Every small business eventually hits a rough patch. It's easy to get discouraged when it happens. But look at the upside: you have infrastructure in place, you have existing customers and most importantly, you have the hard-won experience of knowing what works and what doesn't. With that in mind, here are some ideas to get things back on track:

1. **Focus on triage.** Just like a hospital ranks patients for attention according to the severity and urgency of their injuries, you need to rank your biggest issues. First list what needs to be done urgently, such as paying bills, making payroll and delivering orders. Then rank what is most important long-term, like reviewing expenses, improving marketing and advertising, and gathering sales leads.

   This process means setting aside the idealistic business plan you had before you ran into problems and focusing on the nitty-gritty business realities of revenue, expenses and cash flow. You can pick up the business plan after you plug the holes in the boat, and revise it based on what you learned from your difficult period.

2. **Cut costs.** If you are running into troubles you may be spending money on things that aren't working. Try this exercise before trouble is seen on the horizon: ask yourself what you would eliminate first if your business situation took a turn to the worse. Second? Third? You've just made your cost-cutting priority list.

3. **Get market information.** When your business isn't working well, you need to take a closer look at your market. Look at what your most successful competitors are doing. Pick the brains of your customers, your vendors and your employees for their opinions about the products, services and companies in your industry.

4. **Improve your offering.** Based on what you've learned from your market research, make improvements to your product or service. Use your research and business experience to help you narrow down your list to a few ideas, which you can then test through trial-and-error. One of the most disciplined ways to do this is through A/B testing: create two versions of your offering with one variable changed. Keep whichever one does better and scrap the other, then offer a new A/B test using the improved version. Your products or services will get better over time based on market feedback.

5. **Improve your operations.** Your product or service may be great, but for some reason it's not getting the attention of customers. Meanwhile, a competitor may be outselling you with something inferior. If that's the case, you'll need to revamp your operations: your marketing, advertising, sales and online presence. You can use the same A/B process you used to improve what you're selling to improve how you sell: change one variable at a time and learn from trial-and-error what works and what doesn't.

Remember, great businesses are those that address problems and use them to grow. When seen in this light your business will often become stronger as a result of periodic challenges.

The five-star review trap

(Read this before using star ratings for your business)

When a five-star consumer rating system for products and services was adopted by major online businesses including Amazon, Yelp and Trip Advisor, the practice soon became widely used. But other businesses such as Netflix ditched star ratings after discovering some downsides. Here are some things to consider before you adopt a star rating system in your own online business:

- **Troublemakers love it.** Unfortunately, most satisfied users will not bother to rate your product or service, while dissatisfied customers tend to be highly motivated. That gives the complainers too much power. It's especially risky if your product or service is new. A few low ratings from a disgruntled group can kill a fledgling offering before it even gets off the ground.
- **Competitors love it.** Even great ratings can work against you. Products rated with five stars make it easy for your competitors to know what to copy and what to avoid. For example, if an Amazon reseller's product gets consistent five-star ratings, Amazon sometimes starts selling it directly, often to the chagrin of the reseller who instantly finds their sales being taken over by the online retailing giant.
- **Fixed issues are forgotten.** If dissatisfied customers identify a problem with a product or service through negative one-star reviews, even if you fix the problem the damage will be done. Future sales are likely to suffer because of poor historic ratings, despite the fact that you made improvements. And if you erase the old ratings, it may look like you are being dishonest by tampering with the rating system.
- **Solid sellers look unpopular.** If you introduce star ratings, you may have hundreds of thousands of satisfied customers who don't bother to review the product or service. This can give the perception that no one buys it or it's no good — and perception can soon become reality.

Just because the five-star rating system does not work well in many cases, positive customer feedback is still a great marketing tool. Consider using other formats to collect and showcase sincere customer feedback to demonstrate the goodwill supporting your business.

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How to handle a gap in health care coverage

Health care coverage gaps happen. Whether because of job loss or an extended sabbatical between gigs, you may find yourself without health care for a period. Here are some tax consequences you should know about, as well as tips to fix a coverage gap.

Coverage gap tax issues

You will have to pay a penalty in 2018 if you don't have health care coverage for three consecutive months or more. Last year the annual penalty was equal to 2.5 percent of your household income, or $695 per adult (and $347.50 per child), whichever was higher. The 2018 amounts will be slightly higher to adjust for inflation.

Example: Susan lost her job-based health insurance on Dec. 31, 2016, and applied for a plan through her state's insurance marketplace program on Feb. 15, 2017, which went into effect on April 1, 2017. Because she was without coverage for three months, she owes a fourth of the penalty on her 2017 tax return (three of 12 months uncovered, or 1/4 of the year).

While the penalty is still in place for tax years 2018 and earlier, it is eliminated starting in the 2019 tax year by the Tax Cuts and Jobs Act.

Three ways to handle a gap

There are three main ways to handle a gap in health care coverage:

1. **COBRA.** If you're in a coverage gap because you've left a job, you may be able to keep your previous employer's health care coverage for up to 18 months through the federal COBRA program. One downside to this is that you'll have to pay the full premium yourself (it's typically split between you and your employer while you are employed), plus a potential administrative fee.

2. **Marketplace.** You can enroll in an insurance marketplace health care plan through Healthcare.gov or your state's portal. Typically you can only sign up for or change a Marketplace plan once a year, but you can qualify for a 60-day special enrollment period after you've had a major life event, such as losing a job, moving to a new home or getting married.

3. **Applying for an exemption.** If you are without health care coverage for an extended period, you may still avoid paying the penalty by qualifying for an exemption. Valid exemptions include unaffordability (you must prove the cheapest health insurance plan costs more than 8.16 percent of your household income), income below the tax filing threshold (which was $10,400 for single filers below age 65 in 2017), ability to demonstrate certain financial hardships, or membership in certain tribal groups or religious associations.

Managing money tips for couples

Spring is here and love is in the air. Or, it is as long as you aren't arguing over money with your special someone. Couples consistently report finances as the leading cause of stress in their relationship. Here are a few tips to avoid conflict over finances with your long-term partner or spouse:

1. **Be transparent.** Be honest with each other about your financial status. As you enter a committed relationship, each partner should learn about the status of the other person's debts, income and assets. Any surprises down the road may feel like dishonesty and lead to conflict.

2. **Discuss future plans often.** The closer you are with your partner, the more you'll want to know about his or her future plans. Kids, planned career changes, world travel, hobbies, retirement expectations – all of these will depend upon money and shared resources. So, discuss these plans and create the financial roadmap to go with them. Remember that people in a long-term marriage may be caught unaware if they haven't talked about the future and find out their spouse's priorities have changed over time.

3. **Know your comfort levels.** As you discuss your future plans, bring up hypotheticals: How much debt is too much? What level of spending versus savings is acceptable? How much would you spend on a car, home or vacation? You may be surprised to learn that your assumptions about these things fall outside your partner's comfort zone.

4. **Divide responsibilities; combine forces.** Try to divide financial tasks such as paying certain bills, updating a budget, contributing to savings and making appointments with tax and financial advisors. Then periodically trade responsibilities over time. Even if one person tends to be better at numbers, it's best to have both members participating. By having a hand in budgeting, planning and spending decisions, you will be constantly reminded how what you are doing financially contributes to the strength of your relationship.

5. **Learn to love compromise.** No two people have the same priorities or personalities, so differences of opinion are going to happen. One person may want to spend, while the other

wants to save. Vacation may be on your spouse's mind, while you want to put money aside for a new car. By acknowledging these differences of opinion will happen, you'll be less frustrated when they do. Treat any problems as opportunities to negotiate and compromise. Instead of looking at the outcome as "I didn't get everything I wanted to do," think of it as "I sacrificed some of what I wanted out of love for my partner and he/she did the same for me."