Tax Newsletter

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February 17 - President's Day

The 2019 tax filing season is in full swing. If you have not already done so, now is the time to collect your tax forms, organize your records, and set a schedule to get your tax return completed.

Deep in the Form 1040 instructions is an annual recap of federal income and how the money is spent. Since most taxpayers no longer see these instructions, a recap of this information is provided here for your review.

Given late breaking tax laws, now is a good time to read a review of how newly passed retirement rules could help you save more. This issue also provides some information to help your employees navigate the new W-4 paycheck withholding form.

Please call if you would like to discuss how this information could impact your situation. If you know someone who can benefit from this newsletter, feel free to send it to them.

Finding the Balance of Earning vs. Spending

The IRS primer every voter should know

Every year the IRS publishes instructions to prepare your Form 1040, individual tax return. The publication for 2019 is a whopping 108 pages! On page 103 of the IRS booklet is a summary of collections (income) and spending (outlays) by the federal government. Given the election year, here is a summary of this recap and some general observations.*

2018 Federal Income and Outlays

41%	Personal income taxes	**41%**	Social Security, Medicare, other retirement
28%	Social Security, Medicare, unemployment, and other retirement taxes	**22%**	Social programs
19%	Borrowing to cover deficit	**20%**	National defense, veterans, and foreign affairs
7%	Excise, customs, estate, gift, and misc. taxes	**8%**	Net interest on the debt
5%	Corporate income taxes	**7%**	Physical, human, and community development
		2%	Law enforcement and general government
	Income - $3.330 trillion		**Outlays - $4.206 trillion**

Deficit - ($779 billion)

Observations

23%: The amount of annual spending with no income to cover it.
63%: The amount of spending for social programs, Social Security, and Medicare.
20%: National defense (15%), veterans benefits (4%), foreign aid (1%)
8%: Amount of annual budget required to pay interest on prior year deficits.

Why care?

- **Get rid of the noise.** Political rhetoric is often high during election season, and it is nice to have some facts as to how our taxes are actually spent.
- **Ah ha…this is a key reason interest rates are low.** Wondering why your bank savings interest rate is so low? In part, it is because they are related to federally set interest rates. Imagine if the federal interest rates doubled. The amount of our government's spending on interest payments would double to 16 percent!
- **Very little is optional.** Debt payments, veteran obligations, Social Security, Medicare. All these payments, plus many others are mandatory. These amounts alone, are over 75% of spending.
- **Start the conversation.** Currently, very little of the national conversation is centered around fiscal responsibility (the act of balancing income and outlays). No matter your side of your political leaning, perhaps this should be a starting point for everyone.
- **Learning for all of us.** Take a lesson here and see how your household income and spending stack up. Then create a plan to balance your income and outlays. Use tax planning as one of the key tools to do this.

Want to learn more?
The website www.usafacts.org is a great resource for an objective review of the numbers. This nonprofit is committed to providing the figures and letting you decide what they mean to you.
**for fiscal year 2018 ending September 30, 2018.*

How to Take Advantage of the New Retirement Rules

The Setting Every Community Up for Retirement Enhancement Act, also known as the SECURE Act, was passed by Congress in late December 2019. Here are some of the features in the new legislation that will help you save more for retirement:

- **Money can continue to grow tax deferred**
  If you turn 70½ in 2020 or later, you can keep money in a tax-deferred IRA or 401(k) for another 18 months to help the account continue growing before starting to withdraw funds. This retirement benefit is now available thanks to the required minimum distribution age being raised from 70½ to 72.

  Action: *Review your retirement account distribution needs and use this extra time to help make your distributions more tax efficient. For example, if you have $10,000 before you hit the next highest tax bracket, consider pulling more out of your retirement account. Or use the extra time to consider converting some funds to a Roth IRA.*

- **Contribute to a traditional IRA at any age**
  While taxpayers have always been able to contribute to a Roth IRA at any age, 70½ was the cut-off for making contributions to a traditional IRA. You can now contribute to a traditional IRA at any age provided you have earned income.

  Action: *This is a great opportunity for retirees working part time to consider building their retirement nest egg.*

- **Certain part-time workers can now contribute to 401(k) plans**
  Most part-time workers have never been eligible to participate in an employer's 401(k) plan. The law now mandates employers which maintain a 401(k) plan to offer one to employees to worked more than 1,000 hours in one year, or 500 hours over 3 consecutive years.

  Action: *If interested in participating, contact your employer to determine if and when this option might be added to your company's retirement savings plan.*

- **Use retirement funds to offset the costs of a new birth or adoption**
  Each parent can withdraw $5,000 out of their retirement account without the 10% penalty. The distribution, however, must still be reported as taxable income. The distribution can be repaid as a rollover contribution to an eligible defined contribution plan or IRA.

  Action: *If considering this alternative, make sure the withdrawal is within one year of the birth or adoption. Also retain records to prove the withdrawal is for a qualified event as how this is going to be administered is still up in the air.*

- **Watch out for auto enrollment**
  The government thinks you should be saving more for retirement. So, the new law allows a greater portion of your paycheck to be automatically transferred to an employer's retirement plan. The maximum contribution that can now be automatically deferred into your employer's 401(k) plan has increased from 10% to 15%.

  Action: *While saving more for retirement is a great idea, this automatic participation does not account for your particular situation. Be aware of this law and independently determine what you can afford to put towards retirement. Remember, you also need to build an emergency fund and pay your bills!*

New W-4 Creates Questions for Human Resources

With the major Form W-4 overhaul for 2020, you may field questions from your employees. While it's not your responsibility to provide tax advice to your employees, it's good to be prepared to help answer common questions about the new IRS form. Here is a summary of the W-4 changes and answers to some common questions you might encounter:

The change

Form W-4 was changed by the IRS in an attempt to make payroll withholdings more accurate and easier for employees to understand following the implementation of the Tax Cuts and Jobs Act.

The new Form W-4 eliminates the sometimes-confusing allowance system, replacing it with targeted questions, worksheets and fields for dependents, other income, and anticipated deductions.

Gone are days of simply increasing or decreasing allowances to get the proper withholding — making a change now requires some tax forecasting.

5 common questions about the new Form W-4

1. **Do I have to submit a new form?**
   No. The allowances an employee has on a previous Form W-4 will continue to calculate appropriately in 2020. If changing jobs or an employee wishes to adjust withholdings, completing the new W-4 is required.
2. **Are ALL steps on the new W-4 required to be filled?**
   No. Step 1 (personal information) and step 5 (your signature) are the only required sections to complete. If your employee only completes steps 1 and 5, a withholding will be calculated under the assumption that he/she is only taking the standard deduction. If your employee has dependents or wishes to make other withholding adjustments they will need to fill out other steps in the form.
3. **Do employees have to complete all the worksheets?**
   No. However, the worksheets are intended to provide a more accurate withholding amount. If an employee has multiple jobs or itemizes deductions, the worksheets will help the payroll department withhold the proper amount from a paycheck while accounting for these other factors.
4. **Will completing the new W-4 affect refunds?**
   If an employee has the exact same tax situation (income, deductions and credits) in 2020 as they did in 2019, the tax calculation should have minimal impact on the tax refunded or owed. If there is a need to adjust withholdings at any time during 2020, however, the anticipated refund might look a lot different if an employee does not take the time to carefully complete the new Form W-4.
5. **Should an employee adjust their withholdings?**
   This, of course, is up to the employee. It is best to coach them to speak to their tax advisor. But let them know that it really depends on them. If they want to maximize monthly cash flow or wish to receive a larger refund, then they need to go through the W-4 exercise. While more complicated, per the IRS, this new form allows for less guessing when it comes to forecasting their April tax bill. A simple tax forecast that factors in last year’s tax situation and accounts for changes in the current year will provide clarity to the amount that needs to be withheld.

Remember, to avoid an underpayment tax penalty an employee must withhold 100% of last year’s tax bill or 90% of this year's tax bill. This moves to 110% of last year's bill if income is over $150,000 ($75,000 if married filing separate). Finally, coach your employees to double check their paycheck after any change, it is never fun to be surprised by a big tax bill because withholdings are too low.

Setting up Your Business Accounting System

You've done the hard work. You have a new business idea, or you've found an existing business to purchase. Want to help ensure your business success? Pay attention to correctly setting up your business' accounting system. Here's how:

- **Consider business entity.** Choosing the right legal and tax entity for your business is important. Consult experts to discuss your options. On the tax side, sole proprietors use a Form 1040 Schedule C to report their activity, while other business entities such as S-Corporations and Partnerships file informational returns and pass-through profits to your individual tax return. C-Corporations require separate tax returns without pass-through of profits onto your personal tax return.

- **Determine if you'll use cash versus accrual basis.** There are different approved methods of accounting. You will need to determine which is best for you. Sometimes your business dictates a required method, but not always. The basic difference lies in when you can book revenue and expense. One method (cash) is based upon when you actually receive or make payment. While the accrual method allows capturing this same information when there is an established obligation.
- **Separate your books.** If starting a business from scratch, remember to set up separate bank accounts and recordkeeping. IRS auditors are quick to disallow expenses when your business expenses are mingled together with personal expenses. The same is true with credit cards. Use a separate credit card for your business transactions.
- **Use sub-ledgers.** Well-run businesses understand the need to organize elements of their business into accounting categories. These categories often use their own reporting system called sub-ledgers. Common areas are sales, accounts receivable, accounts payable, fixed assets, and inventory.
- **Honor cash flow.** Often success or failure of your business is predicated on whether you have enough cash to pay your bills. Determining your cash needs means understanding the cash situation of your business. To do this requires a good set of records. This includes recording your current situation on a timely basis and establishing a forecast of cash needs throughout the year.
- **Create a fortress balance sheet.** Banks love a strong balance sheet. If you think your business may need money for expansion, you will want to focus on developing a strong balance sheet that is low in debt and high in liquid assets like cash and accounts receivable. The irony here is that it's easy to borrow money when your records show you don't need it and it's hard to borrow money when you do need the funds.
- **Identify financial pressure points.** Every business has a few financial items that drive profitability. Do you know yours? It might be payroll in a labor-intensive business. It might be rent in a retail establishment. Perhaps your margins are low because of heavy promotional costs. A strong accounting system will help you stay focused on the more important financial elements of your business.
- **Understand seasonality.** By setting up a good accounting system AND forecasting performance over a twelve-month period, you will understand the true needs of your business. This is especially important if your business is seasonal in nature.

Remember, by spending time setting up the accounting system that is right for you, you are increasing your business' chance for success.

You NEED These Documents to File Your Taxes!

It’s easy to get inundated with documents during tax season. You can receive documents from many different organizations, including employers, financial institutions and others. Many documents are now also being sent via e-mail, which increases the likelihood it could get lost in your inbox.

As tax season is quickly approaching, here are some of the documents to be on the lookout for:

- **W-2s**
  While W-2s are the most widespread and well-known tax form, it can be easy to lose track of W-2s if you or your spouse have multiple jobs. Keep track of each employer to ensure you receive the forms in time.
- **1099-INTs and 1099-DIVs**
  Most of us receive small interest or dividend payments throughout the year. These payments are reported on a Form 1099 and must be included on your Form 1040. Depending on the type of investments, there could be numerous 1099s to report this interest and dividend income. Make a list from last year's tax return to help keep track of these 1099s as they arrive via mail or e-mail.

- **1099-Rs**
  Form 1099-R is used when a distribution is made from a pension or retirement account. You could receive a 1099-R if your employer was part of a recent merger, and the company which was acquired rolled its retirement funds into the new company's plan. You could also receive a 1099-R if you get a new job and you roll your existing retirement funds into your new company's plan.
- **Form 1095**
  Different versions of Form 1095 are sent to you recapping your health insurance. While the penalty for not having proper health insurance is suspended for 2019, the form may still be important. So, look for it and retain it with your other records.
- **Get Organized**
  You will also need any documents that confirm and support any deductions you plan to take. For instance, you may need documentation to claim deductions for day care expenses, educational expenses (form 1098-T), mortgage interest documentation (form 1098), proof of medical, dental, and vision care, charitable contributions, business records, property taxes, state taxes, and much more.

It is best to use last year's tax return PLUS a tax organizer to ensure you have all the proper records needed to accurately prepare your tax return. The organizer is especially helpful as there are a list of questions to help you jog your memory to recall certain events that have taken place over the past year that might have a tax consequence. If in doubt, save the documentation, proof of payment, and any receipts!

As always, should you have any questions or concerns regarding your tax situation please give us a call.
