Spring & Co.
CERTIFIED PUBLIC ACCOUNTANTS

Tax & Business Alert

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RUNNING YOUR PERSONAL FINANCES LIKE A BUSINESS

Most individuals don't regard themselves as businesses, trying to turn a profit and beat the competition. But, occasionally, it may help to look at your financial situation this way to determine where you might cut expenses and boost cash flow. Here are some tips.

LAY OUT YOUR FINANCIALS

Where an executive might reach for financial statements to get a read on the company's standing, you can create or update a net worth statement. Essentially a monetary scorecard, a net worth statement helps you determine where you stand financially and whether you're on track to meet your goals.

You can calculate your net worth by adding all your assets, including cash and cash equivalents, brokerage account balances, retirement funds, real estate and other fixed assets and personal property. Then subtract your liabilities, including mortgages, personal loans, credit card balances and taxes due.

The result provides some important clues about where your money is going and how you might be able to trim spending and increase savings. Are you overrelying on credit cards with high interest rates? Could you cut back on food or entertainment costs?

PRACTICE RISK MANAGEMENT

To maintain their companies' financial health, business executives also practice risk management. You can do the same by first assessing compensation and benefits elections. A major life change — such as a marriage or birth — may require an update to your W-4 withholding allowances with your employer.

Unexpected medical costs can be a huge risk. Review your health insurance to ensure it's providing the best value. Now might not be an ideal time to switch to a spouse's plan but, if it's a better deal, perhaps make a note to do so when you can. Also, if you have a Health Savings Account or Flexible Spending Account, make sure you're using it to your full advantage.

Think about other insurance, too. Perhaps your home has increased in value, necessitating a corresponding increase in your homeowner's coverage. Or maybe you no longer have enough life insurance to protect your growing family. Talk to your insurance professional to determine the right amount of coverage.

Finally, check your credit report. If you wait until something is obviously wrong, it may be too late to prevent significant damage. Federal law requires the three major credit reporting agencies to provide you with one free report per year.

THINK ABOUT RETIREMENT

Business owners must think about succession planning. But even if you don't own a company, you should think about life after employment.

If your employer allows you to adjust your retirement plan contributions during the year, consider boosting them to take full advantage of tax-deferred compounding and, if available, employer matching. Similarly, if you plan to make an IRA contribution this year, do so as early as possible to give your assets more time to grow.

Also review your estate plan and, if necessary, update it. Financial priorities change over time, so make sure the beneficiary designations for your retirement accounts and insurance policies still match your wishes. Check your will or living trust to ensure no changes are necessary. And, if you're looking to reduce the value of your taxable estate, remember that you can make $15,000 ($30,000 for married couples) in annual exclusion gifts per recipient this year without using up any lifetime exemption.

GET ROLLING

Some might say that the beginning of the year is the most important time for financial planning. Others might say it's year end, when you start preparing to file your tax return. In truth, the whole year is important. And right now, with the arrival of spring and the year well under way, is a perfect time to adjust objectives set a few months ago — and really get rolling. Contact us for help. ■

BUSINESS VS. HOBBY: THE TAX RULES HAVE CHANGED

If you generate income from a passion such as cooking, woodworking, raising animals — or anything else — beware of the tax implications. They'll vary depending on whether the activity is treated as a hobby or a business.

The bottom line: The income generated by your activity is taxable. But different rules apply to how income and related expenses are reported.

FACTORS TO CONSIDER

The IRS has identified several factors that should be considered when making the hobby vs. business distinction. The greater the extent to which these factors apply, the more likely your activity will be deemed a business.

For starters, in the event of an audit, the IRS will examine the time and effort you devote to the activity and whether you depend on income from the activity for your livelihood. Also, the IRS will likely view it as a business if any losses you've incurred are because of circumstances beyond your control, or they took place in what could be defined as the start-up phase of a company.

Profitability — past, present and future — is also important. If you change your operational methods to improve profitability, and you can expect future profits from the appreciation of assets used in the activity, the IRS is more likely to view it as a business. The agency may also consider whether you've previously made a profit in similar activities. Also, the intent to make a profit is a key factor.

The IRS always stresses that the final determination will be based on all the relevant facts and circumstances related to your activity.

CHANGES UNDER THE TCJA

Under previous tax law, if the activity was deemed a hobby, you could still generally deduct ordinary and necessary expenses associated with it. But you had to deduct hobby expenses as miscellaneous itemized deduction items, so they could be written off only to the extent they exceeded 2% of adjusted gross income (AGI).

All of this has changed under the Tax Cuts and Jobs Act (TCJA). Beginning with the 2018 tax year and running through 2025, the TCJA eliminates write-offs for miscellaneous itemized deduction items previously subject to the 2% of AGI threshold.

Thus, if the activity is a hobby, you won't be able to deduct expenses associated with it. However, you must still report all income from it. If, instead, the activity is considered a business, you can deduct the expenses associated with it. If the business activity results in a loss, you can deduct the loss from your other income in the same tax year, within certain limits.

AN ISSUE TO ADDRESS

Worried the IRS might recharacterize your business as a hobby? Contact our firm. We can help you address this issue on your 2018 return or assist you in perhaps filing an amended return, if appropriate. ■

ARE INCOME TAXES TAKING A BITE OUT OF YOUR TRUSTS?

If your estate plan includes one or more trusts, review them before you file your tax return. Or, if you've already filed it, look carefully at how your trusts were affected. Income taxes often take an unexpected bite out of these asset-protection vehicles.

3 WAYS TO SOFTEN THE BLOW

For trusts, there are income thresholds that may trigger the top income tax rate of 37%, the top long-term capital gains rate of 20%, and the net investment income tax of 3.8%. Here are three ways to soften the blow:

1. Use grantor trusts. An intentionally defective grantor trust (IDGT) is designed so that you, the grantor, are treated as the trust's owner for income tax purposes — even though your contributions to the trust are considered "completed gifts" for estate- and gift-tax purposes.

The trust's income is taxed to you, so the trust itself avoids taxation. This allows trust assets to grow tax-free, leaving more for your beneficiaries. And it reduces the size of your estate. Further, as the owner, you can sell assets to the trust or engage in other transactions without tax consequences.

Keep in mind that, if your personal income exceeds the applicable thresholds for your filing status, using an IDGT won't avoid the tax rates described above. Still, the other benefits of these trusts make them attractive.

2. Change your investment strategy. Despite the advantages of grantor trusts, nongrantor trusts are sometimes desirable or necessary. At some point, for example, you may decide to convert a grantor trust to a nongrantor trust to relieve yourself of the burden of paying the trust's taxes. Also, grantor trusts become nongrantor trusts after the grantor's death.

One strategy for easing the tax burden on nongrantor trusts is for the trustee to shift investments into tax-exempt or tax-deferred investments.

3. Distribute income. Generally, nongrantor trusts are subject to tax only to the extent they accumulate taxable income. When a trust makes distributions to a beneficiary, it passes along ordinary income (and, in some cases, capital gains), which are taxed at the beneficiary's marginal rate.

Thus, one strategy for minimizing taxes on trust income is to distribute the income (assuming the trust isn't already required to distribute income) to beneficiaries in lower tax brackets. The trustee might also consider distributing appreciated assets, rather than cash, to take advantage of a beneficiary's lower capital gains rate. Of course, doing so may conflict with a trust's purposes.

OPPORTUNITIES TO REDUCE

If you're concerned about income taxes on your trusts, contact us. We can review your estate plan to assess the tax exposure of your trusts, as well as to uncover opportunities to reduce your family's tax burden. ■

TAX CALENDAR

April 15

Besides being the last day to file (or extend) your 2018 personal return and pay any tax that's due, 2019 first quarter estimated tax payments for individuals, trusts and calendar-year corporations are due today. Also due are 2018 returns for trusts and calendar-year estates and C corporations, FinCEN Form 114 ("Report of Foreign Bank and Financial Accounts" — though an automatic extension applies to October 15), and any final contribution you plan to make to an IRA or Education Savings Account for 2018. SEP and Keogh plan contributions are also due today if your return is not being extended.

May 15

Original due date for exempt organization returns (Form 990).

June 17

Second quarter estimated tax payments for individuals, trusts, and calendar-year corporations are due today.

SMALL BUSINESS OWNERS SHOULD DOUBLE-CHECK THEIR TAX RETURNS

Now more than ever, small business owners need to double-check their tax returns before filing. Why? Because many of the changes ushered in by the Tax Cuts and Jobs Act take effect with the 2018 tax year.

So, if you're about to file, perhaps slow down and go over your return one more time with your CPA. And if you've already filed, don't forget that you can generally file an amended return within three years of the original filing or within two years of the date on which you paid the tax (whichever is later).

What are some new or expanded tax breaks? First, there's the increase of bonus depreciation to 100% and expansion of qualified assets to include *used* assets — effective for assets acquired and placed in service after September 27, 2017, and before January 1, 2023. The Section 179 expensing limit has also been increased to $1 million and the expensing phaseout threshold has been raised to $2.5 million. (These amounts will be indexed for inflation after 2018.)

Some tax breaks have been reduced or even eliminated. For example, deductions for net interest expense exceeding 30% of a company's adjustable taxable income are now disallowed (with some exceptions). There are also new limits on net operating loss deductions and on excessive employee compensation. Also limited are deductions for certain employee fringe benefits, such as entertainment and, in some circumstances, meals and transportation.

These are just a handful of the items that have undergone notable changes from last tax year to this one. We can help you identify how your small business has been affected and how to adjust your tax planning accordingly. ■

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