tax report

NOVEMBER 2017

king + company
CERTIFIED PUBLIC ACCOUNTANTS
3400 Dutchmans Lane
Louisville, KY 40205
(502) 459-5000

Time for Year-end Planning

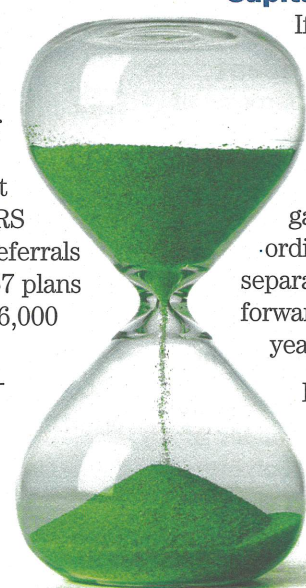
It's that time of year again — when a little planning can potentially save you taxes when you file your return with the IRS next year. Here are some strategies to consider.

Prepay State and Local Taxes

The IRS generally will allow you to deduct any state income taxes paid during 2017 as an itemized deduction. If you would normally wait until January of next year to pay the fourth installment of estimated state income tax for 2017, consider paying it before the end of 2017. This will enable you to include the payment in your 2017 itemized deductions. Similarly, you might consider paying deductible real estate taxes before the end of 2017. Note, however, that these strategies will not be beneficial if you are subject to the alternative minimum tax (AMT).*

Save for Retirement

Another way to reduce your income tax bill is to contribute to a tax-favored retirement account — either through your employer's retirement savings plan or an individual retirement account (IRA). For 2017, the IRS dollar limit on elective salary deferrals to 401(k), 403(b), and most 457 plans is $18,000, plus an additional $6,000 for those 50 and older. (Your employer's plan may have additional limits.) Elective deferrals must be made before year-end.



Additionally, you may contribute up to $5,500 ($6,500 if you're age 50 or older) to an IRA.** Contributions to traditional IRAs are generally deductible, though the deduction is phased out above certain income levels if you or your spouse is an active participant in a retirement plan at work. IRA contributions for 2017 may be made up until the due date (without extensions) for your 2017 return.

Contribute to an HSA

If you are covered by a high-deductible health plan and meet other requirements, you may make deductible contributions to your health savings account (HSA) at any time up until your income tax return due date (without extensions). Generally, for 2017, the limits are $3,400 for self-only coverage and $6,750 for family coverage. Individuals who are age 55 or older at year-end and not enrolled in Medicare may contribute an additional $1,000.

Capital Gains and Losses

If you incurred capital losses in 2017, you may want to consider selling appreciated stocks that you no longer want to hold so that you can offset the losses against the gains. Capital losses can be used to offset capital gains *plus* an additional $3,000 of ordinary income ($1,500 if married filing separately) annually. You may also carry forward unused capital losses to future tax years, subject to the same limitations.

Please contact us if you'd like to discuss tax planning strategies. ■

* At the time of publication, lawmakers are considering tax reform proposals that include potential repeal of the deduction for state and local taxes and the AMT, among other changes.

** The IRA contribution can't exceed your (and your spouse's) taxable compensation.

RMD Reminder

If you turned (or will turn) 70½ in 2017, you need to be aware of the upcoming deadlines for required minimum distributions (RMDs) from both individual retirement accounts and retirement plan accounts, such as 401(k)s. If you don't take RMDs on time, you could get hit with a tax penalty equal to 50% of the undistributed RMD.

When To Begin

Generally, the deadline for taking RMDs is the end of each calendar year. However, the IRS allows an extension for the first one — until April 1 of the following year.

The bad news is that if you decide to wait until April 1, 2018, to take your first RMD, you'll still need to take your second by the end of that same year. With two RMDs in one year, you'll have more taxable income, and you might even be pushed into a higher tax bracket and/or see more of your Social Security benefits taxed.

short takes

$33 Million Deduction Lost Due to Missing Cost Information

Where a partnership claimed a $33 million charitable contribution deduction for the donation of a property interest it had acquired a year and a half earlier for $2.95 million, the Tax Court disallowed the deduction because the taxpayer had failed to disclose the property's cost basis on the required appraisal summary. The Tax Court found the omission to be "material" because the required cost information would have alerted the IRS to the substantial disparity. The IRS also assessed the taxpayer with penalties for gross valuation misstatement.

RERI Holdings I, LLC v. Comm'r, 149 TC 1 (July 3, 2017)

401(k) Plan Loan Deemed Taxable

Where a taxpayer failed to begin making timely repayments of her plan loan and did not pay the delinquent amounts within the plan's allowed grace period, the Tax Court deemed the entire loan a taxable distribution. Prior to taking a leave of absence to have a child, the taxpayer took out a $40,000 loan and arranged to have the repayments automatically deducted from paychecks she would receive during a portion of her absence. However, the employer neglected to make the deductions, and the taxpayer didn't notice the error until after she had returned to work — after the grace period had expired. Since the taxpayer was under age 59½, she was also assessed with the 10% tax penalty for early withdrawals.

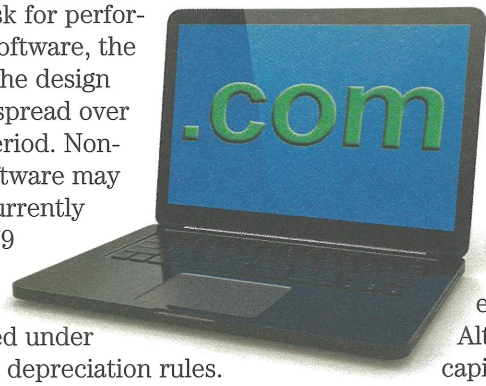
Frias v. Comm'r, TC Memo. 2017-139

Analyzing Business Website Costs

How should the expenses incurred in launching a business website be treated for income tax purposes? Following is an overview of the federal tax rules and options that may be available.

Software costs. Website designs produced with sophisticated programming languages generally can qualify as software. The IRS has safe harbor rules for deducting software costs. These rules distinguish between software produced by independent contractors and software produced by in-house employees.

Generally, if the design was "purchased" from an outside contractor who remains at economic risk for performance of the software, the deduction for the design costs must be spread over a three-year period. Non-customized software may be deducted currently as a Section 179 expense (subject to limits) and/or deducted under the 50% bonus depreciation rules.



However, if the website design is "developed" in-house — or by an independent contractor who does not remain at risk for performance — costs may be deducted currently or amortized over a three-year period.

Other costs. Website design costs that don't qualify as software are deducted over their expected useful life. The costs of producing website content that is considered advertising are generally currently deductible.

Start-up costs. Website costs incurred before a business begins may be considered start-up costs. A business may elect to deduct up to $5,000 of start-up costs in the year the business begins operations and deduct the remaining costs ratably over 180 months. (The $5,000 deduction is reduced where total start-up expenses exceed $50,000.) Alternatively, a business may capitalize its start-up costs. ■

Claiming College Students as Dependents

Does your child/college student qualify as your dependent? If so, you may be eligible for certain tax breaks.

Qualification as a Dependent

To be a "qualifying child" for purposes of the dependency exemption, a child must:

- Live in your home for over half the year (temporary absences for education don't count)
- Be your child, stepchild, adopted child, or foster child or your brother, sister, or stepsibling (or a descendant of any of these)
- Be under 19 or a "student" under 24 and be younger than you (or be permanently and totally disabled)
- Not provide over half of his or her own "support" for the year
- Be a U.S. citizen or a resident of either the U.S., Canada, or Mexico (with an exception for certain legally adopted children)
- Not file a joint return for the year*

"Student" means a full-time student for at least five months of the year, so a college senior graduating in May or June can qualify. Also, "support" does not include a scholarship received by a full-time student and applied to his or her education if the student is your child.

Potential Tax Benefits

For 2017, the dependency exemption can potentially reduce your taxable income by as much as $4,050. Moreover, the American Opportunity Tax Credit (AOTC) or the Lifetime Learning Credit (LLC) may be available if your child/student qualifies as your dependent.

However, these benefits are phased out at higher income levels. In this situation, you may want to consider not claiming your child as a dependent if doing so would allow your child to claim the AOTC or LLC. (Your child wouldn't be entitled to a personal exemption.) ■

* If a child doesn't meet all the requirements, a "qualifying relative" test may be available.

Job Change Checklist

Taxes might be the last thing on the mind of someone making a job change, but failure to take them into account could make for some unpleasant surprises at tax time. Here are a few issues to consider.

Health Insurance Coverage

If you are losing your employer-sponsored health coverage, you may be able to rely on your spouse's insurance. If not, you should know that, generally, private employers with 20 or more employees and state and local governments are required to allow terminating employees to continue their health insurance coverage, at their own expense, for themselves, their spouses, and dependent children ("COBRA" coverage). Typically, you should expect COBRA premiums to be higher because your employer will no longer be paying a portion. You may want to seek out more affordable options through the Health Insurance Marketplace.

Health insurance premiums are qualified medical expenses and, therefore, eligible to be taken as an itemized deduction. However, medical expenses are deductible only to the extent they exceed 10% of your adjusted gross income (AGI).

Last Paycheck

Your final paycheck may include — in accordance with your employer's policies — payment for accrued but unused holiday/vacation and sick leave, unpaid commissions and bonuses, and severance or termination pay. These items will be included in your gross income for the year and are subject to both income and FICA (Social Security and Medicare) taxes. Depending on your situation, you may want to amend your W-4 (*Employee's Withholding Allowance Certificate*) before the payment is made to ensure you'll have the proper amount of income taxes withheld for the year.

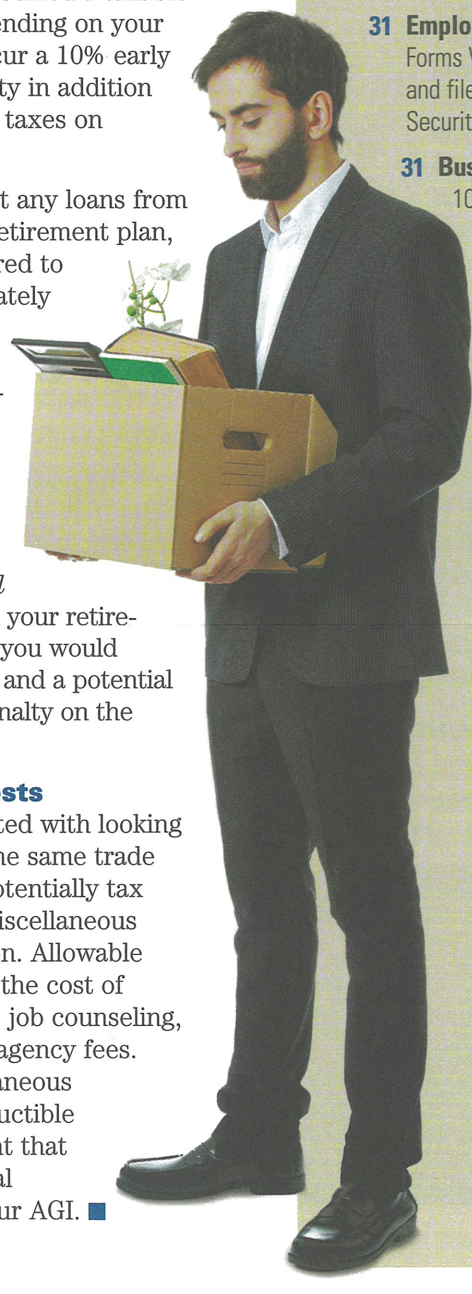
Employer-sponsored Retirement Plan

If you participate in your employer's qualified retirement plan, you'll want to pay particular attention to your distribution options. Generally, you may either take an immediate taxable distribution or make a *direct* or *indirect rollover* to another tax-favored retirement account.

From a tax standpoint, the direct rollover is usually the preferred option when you are switching jobs because it allows you to avoid current taxes and continue saving for retirement. Typically less desirable is the indirect rollover, which would involve you receiving the money first and then depositing it in another retirement plan or individual retirement account within 60 days.

An indirect rollover presents a potential tax trap since your employer is required to withhold 20% of the balance and forward it to the IRS to be applied to your federal income tax liability for the year. You'll have to make up that 20% shortfall with money from an outside source to complete a rollover of the full amount within 60 days. If you don't, the 20% withheld will be deemed a taxable distribution. Depending on your age, you could incur a 10% early distribution penalty in addition to regular income taxes on the shortfall.

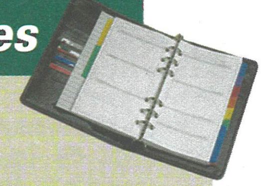
If you've taken out any loans from your employer's retirement plan, you may be required to pay them immediately or within a specified period following termination. Failure to repay the loan on time can result in your former employer reporting it as a *deemed distribution* from your retirement plan. Again, you would owe income taxes and a potential additional 10% penalty on the amount.



Job Search Costs

Expenses associated with looking for a new job in the same trade or business are potentially tax deductible as a miscellaneous itemized deduction. Allowable expenses include the cost of résumés, postage, job counseling, and employment agency fees. However, miscellaneous expenses are deductible only in the amount that the combined total exceeds 2% of your AGI. ■

Calendar of Filing Dates



NOVEMBER

10 Employers: Deferred due date for Form 941, if timely deposits were made.

DECEMBER

15 Corporations: Pay fourth installment of 2017 estimated tax.

JANUARY

16 Individuals: Pay last installment of 2017 estimated tax with Form 1040-ES. Or file 2017 income tax return and make full payment of any balance due by January 31, 2018.

31 Employers: Distribute copies of Forms W-2 for 2017 to employees and file same with the Social Security Administration.

31 Business: Distribute Forms 1099 (or other information statements) to recipients of certain payments made in 2017. See us for more details.

31 Employers: File Forms 1099-MISC if you are reporting nonemployee compensation payments in box 7.

31 Employers: File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

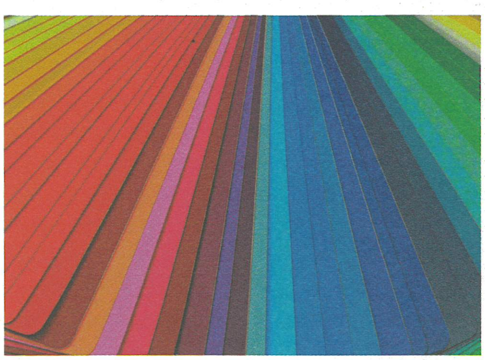
31 Employers: File Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 2017.

The Many Types of Tax-exempt Organizations

The tax rules authorize over 25 different types of tax-exempt organizations. Your credit union might be a 501(c)(14), while your child's daycare might be a 501(c)(3). Such designations are significant because they determine permissible activities, filing requirements, and eligibility to accept tax-deductible contributions.

Section 501(c)(3) Organizations

Nonprofits that are organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes can obtain tax-exempt status under Section 501(c)(3). Also under Section 501(c)(3)'s umbrella are nonprofits engaged in testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals.



With the exception of organizations that test for public safety, 501(c)(3) organizations are both exempt from federal income tax and eligible to receive tax-deductible contributions. Political and legislative (lobbying) activities are restricted.

Other Types

While Section 501(c)(3) organizations are the most prevalent types of tax-exempt entities, others include:

- Social welfare organizations, civic leagues, and local associations of employees that serve charitable, educational, or recreational purposes — Section 501(c)(4)
- Trade associations, professional associations, chambers of commerce, and other business leagues — Section 501(c)(6)
- Social and recreation clubs — Section 501(c)(7)
- Fraternal societies — Sections 501(c)(8) and 501(c)(10)
- Veterans organizations — Sections 501(c)(19) and 501(c)(23)

Most, though not all, of these organizations are prohibited from taking tax-deductible contributions.

Caution Required

An organization can be formed as a nonprofit corporation under state law but not qualify as a tax-exempt organization under federal income tax law. And, even a tax-exempt organization can owe federal income taxes if it has "unrelated" trade or business income. ■