TaxTips

Keeping You Informed ▪ Summer/Fall 2019

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Health Savings Accounts

A closer look at the benefits

Health savings accounts (HSA) are used in conjunction with a high deductible health plan and offer four tax advantages compared to traditional savings and investment accounts:

- Your own contributions to the HSA are tax-deductible.
- Employer contributions to your HSA are excluded from your taxable income.
- Interest, dividends, and gains earned on your funds inside the HSA are not subject to federal tax.
- Distributions from the HSA are tax-free as long as the funds are spent on eligible medical, dental, and healthcare expenses.

Eligible healthcare expenses include prescription medications, prescription eyeglasses, and fees paid to health care professionals or hospitals, just to name a few. With a few exceptions, HSA distributions *not* spent on eligible medical expenses are taxable.

HSAs can also be used to buy over-the-counter medicines as long as your doctor gives you a prescription for it. Additionally, you can tap into your HSA to buy long-term care insurance or to pay for health insurance premiums when you are unemployed.

Despite their attractive tax advantages, health savings accounts are not for everyone. One drawback is that you'll need to have a high-deductible health insurance plan to be eligible to open and contribute to an HSA. "High deductible" means you'll be responsible for paying all or a significant portion of your medical expenses out of your own pocket.

W-4 mid-year checkup

Reviewing your estimates

Making an adjustment to how much tax is withheld from your income or increasing your estimated tax payments can help you avoid an unwelcome tax bill and potential penalties at the end of the year.

With all the tax changes that went into effect in 2018, it's important to review your tax withholding at least once a year.

Opting to not review your withholding for the year and leaving it the way it is could be a mistake. We had several clients not review their withholding and estimated tax payments for any necessary changes. Even though their income was about the same as the previous year, they ended up owing the IRS instead of getting their usual refund.

The culprit was two-fold. Not only did clients lose some deductions resulting from the tax reform changes, but also their withholding went down (even though they didn't change anything) because the IRS changed the withholding tables and the way it's calculated.

We can prevent problems like this by adjusting how much federal and state tax is withheld from your wages, pensions, unemployment benefits, and Social Security benefits. The goal is to pay enough tax that you avoid a balance due and still get a refund when we file your taxes for next year.

The same thought process holds true for self-employed freelancers. Self-employed persons should adjust their estimated tax payments, especially if their business income is increasing.

Signs you may need to adjust your withholding:

- You owed tax this year
- You receive income where no tax is withheld, such as investments, stock gains, or rental income
- You have multiple jobs
- You are recently married or divorced
- You bought a house
- You have dependents
- You itemize your deductions
- You're getting a raise

Working in the gig economy

Tax tips for ride-sharing drivers

Working in shared economy marketplaces like DoorDash, Lyft, or Uber has certain advantages for earning extra income. Some people even make a decent living at it.

If you are working in a gig economy, it's important to remember that these companies don't withhold taxes from the money you earn, but that doesn't mean you're off the hook from paying them. To avoid owing tax at the end of the year, we recommend you pay estimated taxes throughout the year. Alternatively, you could have additional tax deducted from your salary at your day job. The estimated tax calculation can get a little tricky, so just give us a call and we'll help you out.

It's also important that you track how many miles you drive. For 2019, you can deduct 58 cents for every mile you drive your car for business purposes. Every 1,000 miles you drive for Uber or DoorDash amounts to a $580 deduction.

The only way you'll know how many miles you drive is if you keep track of them using a mileage log, either on paper or via a smartphone app. Also, take a picture of your odometer reading on January 1 and December 31. This helps you track how many total miles you drive for the year.

Also track your out-of-pocket expenses. You might offer bottles of water to your passengers, or gift baskets to your Airbnb guests. You can deduct these out-of-pocket expenses on your tax return. Examples of other deductible business-related expenses include:

- Hands-free smartphone mounts for the car
- Smart phone and monthly service
- Parking, bridge tolls, and road tolls
- Linens and soaps utilized by Airbnb guests
- Security cameras and home protection services
- Commissions and fees paid to Uber, Lyft, Airbnb and other networks

If you've purchased any big-ticket items, remember to tell us about them. Maybe you replaced the roof or installed a solar panel in your Airbnb home. Or perhaps you installed a video security system in your Uber car. We can help you decide if these are expenses that need to be spread out over several years through depreciation, or if you can deduct some or all of them right away.

In addition to mileage logs and expense records, keep your 1099 forms and other tax documents. Gig economy companies report income paid to you on a Form 1099. Some companies will send you Form 1099-MISC, while others will send you a Form 1099-K. Some might even send you both, or none at all. The important thing is to keep copies of any tax documents and all the income you earn.

Send us copies of the year-end reports and statements you receive. Uber and Lyft, for example, detail their fees and provide an estimate of your mileage on their year-end reports.

Turning 701/2?

Don't forget about your RMD

Older adults who reach age 70½ and are no longer working need to start drawing funds from their retirement savings accounts, making sure they meet their required minimum distribution (RMD) for the year. RMDs apply to funds saved in traditional IRA, SEP IRA, SIMPLE IRA, 401(k), 403(b), 457, and thrift savings plan accounts. The RMD rules do not apply to a Roth IRA, Roth 401(k), or Roth 403(b).

You only need to remember a few rules. First, you have a choice. You can begin taking RMDs in the year you reach age 70½. Alternatively, you can wait and take your first RMD by April 1 of the following year. Keep in mind that if you wait until April 1 of the following year, you are required to take two distributions in that year.

For example, if you turn 70½ on July 4, 2019, you'll take your first RMD either by December 31, 2019, or by April 1, 2020. For all subsequent years, you'll need to take your RMD by the end of the year.

If you turned 70½ on July 4, 2019, and you decide to take your first RMD by April 1, 2020, this will satisfy your first RMD. (This makes the distribution taxable in 2020.) You'll also need to take your second RMD by December 31, 2020. This satisfies your RMD for the year 2020. In this scenario, you have two distributions taxable in 2020. Going forward, for the year 2021, you'll take your RMD by December 31, 2021.

Finally, determine how much RMD you need to take out. Each year, we need to calculate your required minimum distribution. This is the minimum amount you'll need to withdraw from your retirement accounts to meet the requirement.

We can help you calculate your RMDs, so you can rest assured you're meeting the requirement. All we need are the Form 5498 documents that your retirement plan administrators send to you.

Tax-free reimbursements of business expenses

Accountable plan basics

The Tax Cuts & Jobs Act (TCJA) of 2017 (tax reform) has all but abolished miscellaneous itemized deductions for the majority of taxpayers. When coupled with the doubling of the standard deduction, the opportunity for most taxpayers to itemize deductions is essentially eliminated until the TCJA expires in the year 2025. Employees who previously relied on large miscellaneous itemized deductions to help reduce their tax burden no longer have a place to deduct expenses such as travel and mileage. Fortunately, there is a work around already built into the tax system called accountable plan reimbursements.

Businesses can reimburse owners and employees for out-of-pocket expenses under an accountable plan, a set of rules and processes that allow tax-free reimbursements of certain business expenses. To qualify, an accountable plan must contain the following three terms and conditions:

1. Employees must substantiate their expenses by providing the business with a written statement of expenses they paid, along with receipts and any other documents needed to prove the expense is legitimate. The documentation must show the amount paid and the business purpose for the expense. Employees also need to document the time and place of any travel or meal. For gifts given to clients or vendors, employees should also describe what was given and how the recipient of a gift is related to the business.
2. The company can only reimburse employees for tax-deductible expenses related to the business. Expenses should be approved for reimbursement only if the expense relates to the business.
3. The company must require employees to return any excess advances in a timely manner.

Your accountable plan should detail when employees need to provide you with substantiating documents and to return any funds paid out in advance that were not spent on legitimate business expenses.

The IRS provides two safe-harbor methods for preserving the advance as a tax-free reimbursement. We highlight just one method—the fixed date method—to illustrate what we mean by the time constraint. Using this method:

- The business advances funds only within 30 days of when the expense is paid;
- The employee requests reimbursement and provides substantiating documents within 60 days of paying the expense; and
- The employee returns any excess advances within 120 days after the expense is paid.

The best time to set up an accountable plan is now. We can advise you on how to set up expense reports and reimbursement processes that will pass IRS muster.

Making home improvements?

Rules for deducting interest on home equity debt

Homeowners can deduct interest paid on home equity loans or home equity lines of credit if they use the loan proceeds for making home improvements. However, if the home equity loan is used to pay for anything else, like college tuition or a new car, the interest on that loan won't be tax deductible.

Homeowners need to be careful when taking out a loan secured by their house. Not all home equity loans qualify for the mortgage interest tax deduction. We need to look at how you spent the loan proceeds when figuring out if your loan interest is deductible.

For tax years 2018 through 2025, homeowners can deduct interest paid on mortgages and home equity debt as long as they spend the loan proceeds to buy, to build, or to substantially improve their main home or a second home.

Here's how to make sure your home equity loan or line of credit will be tax deductible:

- The loan must be secured by your main home or a second home.
- The new home loan, plus any existing mortgages, must have a combined loan balance of $750,000 or less ($375,000 for married couples who file separately). Interest on balances over this limit is not tax deductible.
- The proceeds of the home equity debt must be used to substantially improve your home.

From the IRS's perspective, home improvements are "substantial" if the improvement adds value to your home, extends the useful life of your property, or adapts your home to new uses.

Examples of substantial home improvements:

- Adding a bedroom or bathroom to your house
- Adding a deck, porch, patio or garage
- Building a swimming pool
- Building or replacing a fireplace
- Installing a security system
- Installing built-in appliances
- Installing heating or central air conditioning systems
- Installing new windows, siding or a satellite dish
- Laying new carpet or flooring
- Modernizing the kitchen
- Building a new fence or retaining wall
- Installing new insulation in the attic, walls, floors, or around pipes
- Installing new water heaters and filtration systems
- Paving the driveway
- Replacing the roof
- Replacing the septic system
- Re-wiring the house

Examples of what's not a substantial improvement:

- Repainting your house
- Making ordinary repairs that maintain your home in good condition

Let us know about any new or refinanced home loans. We can help you determine if the interest will be tax-deductible and can help you keep proper documentation for tax purposes.

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Getting married or divorced?

Things you need to know when changing your name or address

People change their names for any number of reasons. You might be taking your spouse's surname after getting married, or you might be going back to your maiden name after getting divorced.

If you change your name, you must notify the Social Security Administration (SSA) and get a new Social Security card.

Do this before filing your next tax return with the IRS. Their computers check your name and Social Security number against SSA's records. If your name doesn't match exactly, that could cause e-file rejections or delays in processing your tax return.

Reporting your name change to SSA cannot be done online. Instead, you'll need to fill out Form SS-5 to change information on your Social Security record. You'll also need documents proving your legal name change, such as a court order, marriage document, or divorce decree. You can either mail in your name change request or visit a local SSA office.

After receiving your new Social Security card, use your new name on your tax returns. Be sure to tell us, too, so we can update our records with your new name.

And let us know if you are moving. By filing Form 8822, *Change of Address*, we can notify the IRS of your new address so any important letters or notices will reach you without getting lost in the mail.