

# Client Bulletin

Smart tax, business and planning ideas from your Trusted Business Advisor<sup>SM</sup>

April 2019

## The standard deduction's double standard



The 2019 “tax season,” during which most 2018 tax returns are prepared, will soon peak at the April 15 deadline. One key trend is that more people are taking the standard deduction, which has increased significantly, and fewer people are claiming itemized deductions, which have been restricted.

These changes result from passage of the Tax Cuts and Jobs Act (TCJA) of 2017, which affects preparation of 2018 tax returns.

Drilling down, this shift is greater for married couples filing joint returns than for single taxpayers. That’s because state and local tax (SALT) deductions are capped at \$10,000 on single and joint returns. Single taxpayers are finding it easier to find value in itemizing compared with couples filing jointly.

**Example 1:** George and Heidi Miller are both age 67. On their joint 2018 tax return, they can claim a \$24,000 standard deduction, plus an extra \$1,300 each, because the

IRS considers them aged (over 65). Their total is a \$26,600 standard deduction: \$24,000 + \$1,300 + \$1,300. (In 2019, the basic standard deduction on joint returns increases to \$24,400.)

The Millers pay more than \$30,000 in state income and local property tax, but their SALT deduction is capped at \$10,000. Assume the only other itemized deductions they can claim are \$6,000 for mortgage interest and \$4,000 for charitable contributions. Altogether, the Millers could claim \$20,000 of itemized deductions, but they would be better off taking their \$26,600 standard deduction.

Many married couples will find it difficult to claim more itemized deductions than their standard amount.

### Easier for singles

Conversely, many single taxpayers are finding that it still pays to itemize.

**Example 2:** Laura Carson, age 67, is unmarried. On her 2018 tax return, Laura can claim a \$12,000 standard deduction, plus an extra \$1,600, because she is over 65. Laura’s total is a \$13,600 standard deduction: \$12,000 + \$1,600. (In 2019, those numbers increase to \$12,200 and \$1,650, respectively.)

As is the case with the Millers in example 1, assume Laura can take a \$10,000 SALT deduction; \$6,000 of mortgage interest, and \$4,000 for charitable donations. Her total of

## In this issue

- 1 The standard deduction's double standard
- 2 Homeowner's insurance protects a prime asset
- 3 Roth solo 401(k)s for (very) small businesses
- 4 Tax calendar

## Building up

Led by a 4.2% yearly increase on the nonresidential side, total construction employment totaled 7,352,000 in late 2018, the highest level since early 2008.

\$20,000 is greater than her \$13,600 standard deductions, so it makes sense for Laura to itemize.

The previous examples use taxpayers over age 65. Younger single people also may be likely to itemize because they have only a \$12,000 hurdle to clear (\$12,200 in 2019), which would mean \$2,000 (\$2,200 in 2019) in other deductions if they face the \$10,000 cap on their SALT deductions.

### Planning points

Under the TCJA, married couples may find it difficult to itemize deductions. As mentioned in the **March 2019 CPA Client Bulletin**,

people older than 70½ might want to tap their IRAs for qualified charitable distributions because other contributions deliver no tax benefit for those who take the standard deduction. Younger people may want to front load years of charitable contributions into a donor advised fund, if that results in itemizing for the contribution year.

Married couples with children or other loved ones who file a single tax return may want to make family gifts instead of charitable gifts; in 2019, each person can give up to \$15,000 per recipient with no gift tax consequences. The recipient may be

able to make the desired donation, itemize deductions, and keep a tax benefit in the family.

As for single taxpayers, the key point is to keep itemized deductions in their tax planning. Even with the \$10,000 SALT cap, the standard deduction might not be the best option. Maintain careful records of all medical or dental expenses, which might be deductible, and use savvy tactics for charitable giving, such as donating appreciated securities instead of cash. Itemized deductions are still an option, even if only largely for single filers.

## Trusted advice

### Income tax deductions for casualty losses

- Through 2025, you can deduct only personal casualty and theft losses resulting from a federally declared disaster.
- Deductible amount of the loss is reduced by any salvage value and any insurance reimbursements you receive or expect to receive.
- The deductible amount of your losses for a year are also subject to two other limitations:
  - Each separate casualty or theft loss is reduced by \$100.
  - The total amount of all losses during the year (reduced by the \$100 floor) is reduced by 10% of your adjusted gross income.
- Special rules apply to casualty losses from hurricanes Harvey, Irma, and Maria.

## Homeowner's insurance protects a prime asset

From coast to coast, hurricanes and wildfires and other natural disasters have created headlines while destroying homes. Your principal residence is probably a valuable asset, so you should be confident your homeowner's insurance can protect you against multiple perils.

Chances are, your first experience with homeowner's coverage probably coincided with your first home purchase, which you financed with a mortgage. Many lenders require such insurance, and proof of adequate coverage may be part of the closing process.

### Comprehensive coverage

Regardless of whether you still have a sizable home loan, you should have a homeowner's policy that will cover you and your family as well as the lender. For instance, the policy should have limits that are adequate to replace or rebuild your home after a complete destruction, not just repay the outstanding mortgage loan. Damage or theft of personal

possessions also should be covered. Liability insurance should protect your other assets if a visitor or worker is injured on your property.

Other provisions you might look for include coverage of other buildings on your property (garage, storage shed), living expenses if damages force you to relocate, and theft of possessions. You also might need specialized coverage if you are concerned about damage from floods, sinkholes, or earthquakes.

### Proving loss of personal property

To jog your memory of your possessions, which may be vague if your house and everything in it has been destroyed, it's a good idea to take room-by-room photographs of your possessions and keep them in a remote safe deposit box. It's also advisable to make a specific listing of particularly valuable items, with information about purchase date and price.

Your homeowner's insurance company may have suggested

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forms that you can use to list personal property items before a loss happens. Such information may make negotiating a claim with the insurer quicker and easier.

### Finding good hands

To get the coverage you want, at a reasonable price, you can shop around to compare offerings from multiple insurers. If you are satisfied with your auto insurance coverage (see the January 2019 *CPA Client Bulletin*), look into that company's homeowner's policies. You also can question relatives, friends, or business associates to see if they've had good experiences with an insurer's homeowner's policy.

### State your claim

Keep in mind that homeowner's insurance coverage is not limited

to natural disasters that destroy a home. Lesser damages also may be covered to help you pay for repairs or reconstruction. For example, if you experience a leak in the upstairs shower that results in damage downstairs, you can file a claim and see how the insurer responds.

Don't be reluctant to file small claims. They may provide some needed cash while having little or no effect on future premiums. That said, you might not want to claim a minor occurrence, so why choose a \$250 or \$500 deductible? A \$1,000 deductible may bring down ongoing premiums dramatically.

If you have a claim that runs into five figures, be prepared for some pushback from your insurer. You probably will need an estimate of

the amount of money involved. The insurance company may suggest contractors to provide the estimate, but you might prefer to get one from someone else if you have a reputable worker who has completed satisfactory projects for you in the past.

### Dealing with disputes

A homeowner's insurance company probably has its own formula for estimating the cost of satisfying your claim, and its number may be much lower than one from your contractor. Getting photos and filing your claim as soon as possible may help to lessen the disagreement; and a formal explanation of the likely expenses might lead to a better settlement offer. You may wind up with a compromise that reimburses you for most, if not all, of your costs.

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## Roth solo 401(k)s for (very) small businesses

The Tax Cuts and Jobs Act (TCJA) of 2017 was not officially focused on retirement planning, but it has had a major impact on the choice of retirement plans. After-tax plans, known as Roth accounts, may be more practical now. That can be especially true regarding solo 401(k)s, which are 401(k) plans that cover business owners (including sole proprietors) without employees (other than the owners and their spouses).

Under the TCJA, the income caps for married couples filing joint tax returns is twice the upper limit for single filers in all tax brackets. In most brackets, that's a much wider gap than had been the case in the past.

**Example 1:** Tom and Stella Smith have around \$300,000 a year in taxable income after deductions. In

2017, before passage of the TCJA, their tax bracket was 33%. If they added an extra \$1 of income, they would have owed 33 cents more to the IRS. On the other hand, if Tom put \$1 into a pretax retirement plan, the couple would have deferred 33 cents in income tax.

In 2017, the Smiths might have expected to be in the 28% tax bracket in retirement. (That year, the 28% bracket covered taxable income ranging from \$153,100 to \$233,350). Deferring tax at 33% and ultimately paying tax at 28% seemed like an attractive scenario.

### New rates

In 2019, federal income tax rates have been lowered and the upper limits for tax brackets have risen.

**Example 2:** Tom and Stella expect the same \$300,000 in taxable income

in 2019, which puts them in a 24% tax bracket.

Moreover, current law calls for a return of 2017 tax rates after 2025. The thought of deferring tax at 24% in a pretax retirement plan, and eventually taking distributions in what could be a 28% tax bracket after 2025, reduces the appeal of pretax retirement plans.

Not all business owners will be in situations such as those illustrated in examples 1 and 2. Nevertheless, the underlying principles apply broadly. Lower tax rates make tax-deferred retirement plans less appealing, especially given the prospect of higher tax rates prevailing in the future.

### After-tax plans

If pretax retirement plans are less attractive under the TCJA, then after-

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tax plans may be worth exploring. These plans are known as Roth options, because the Roth IRA was the first such plan. With Roth plans, contributions are made with after-tax dollars. In essence, you pay tax now using today's relatively low rates. Money compounds tax-free inside the plan, and all distributions might be tax-free in the future. Typically, you must be at least age 59½ and meet a five-year holding period test for all distributions to qualify for tax-free treatment.

Some popular small business retirement plans, such as SEP-IRAs, don't offer Roth versions. Therefore, a 401(k) with a Roth option might be a good choice. As a business owner, you can choose to put contributions on the Roth side, and your employees can do the same.

Self-employed individuals and business owners with no employees (other than themselves and their spouses) can have a solo 401(k) with a Roth option. Solo 401(k) plans

and their Roth versions do not require nondiscrimination testing, which can be costly for business owners with regular 401(k) plans.

### Copious contributions

In 2019, participants in solo 401(k) plans can contribute as much as \$19,000 from their earnings, or \$25,000 if they are 50 or older. In addition, employer contributions can be up to 25% of compensation, to a maximum of \$56,000 in total contributions.

Self-employed participants face somewhat different rules, possibly lower contribution limits, and a requirement that employer contributions go into the pretax 401(k). However, it may be possible to pay the tax on those pretax contributions at today's tax rates and move the dollars over to the Roth version, if the paperwork allows such in-plan Roth conversions.

## Tax calendar

### APRIL 2019

#### April 15

**Individuals.** File a 2018 income tax return and pay any tax due by April 15 (if you live in Maine or Massachusetts, the filing deadline is April 17). If you want an automatic six-month extension of time to file the return, file Form 4868, "Application for Automatic Extension of Time To File U.S. Individual Income Tax Return." Then, file Form 1040 by October 15.

If you are not paying your 2019 income tax through withholding (or will not pay in enough tax during the year that way), pay the first installment of your 2019 estimated tax. Use Form 1040-ES.

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in March if the monthly deposit rule applies.

**Household employers.** If you paid cash wages of \$2,100 or more in 2018 to a household employee, file Schedule H (Form 1040) with your income tax return and report any household employment taxes. Report any federal unemployment (FUTA) tax on Schedule H if you paid total

cash wages of \$1,000 or more in any calendar quarter of 2017 or 2018 to household employees. Also, report any income tax you withheld for your household employees.

**Corporations.** File a 2018 calendar year income tax return (Form 1120) and pay any tax due. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

**Corporations.** Deposit the first installment of estimated income tax for 2019.

### MAY 2019

#### May 10

**Employers.** For Social Security, Medicare, and withheld income tax, file Form 941 for the first quarter of 2019. This due date applies only if you deposited the tax for the quarter in full and on time.

#### May 15

**Employers.** For Social Security, Medicare, withheld income tax, and nonpayroll withholding, deposit the tax for payments in April if the monthly rule applies.



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