Tax Impact

May/June 2018

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Tax Tips

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The price of giving

Tax reform's impact on charitable donations

If you make substantial donations to charity, it's important to evaluate the impact of the Tax Cuts and Jobs Act (TCJA) on the "price" of your gifts. Even though charitable giving is motivated primarily by compassion and generosity rather than the availability of tax incentives, the after-tax cost may affect the amount you're willing or able to give.

The TCJA contains several provisions that decrease the tax advantages of charitable gifts for many people (and one provision that boosts the benefits of certain cash gifts). However, be aware that most of the TCJA's individual income tax provisions are scheduled to expire at the end of 2025.

Tax rates lowered

The TCJA cuts tax rates for most (but not all) people, making charitable giving more expensive. Suppose, for example, that a married couple donates $10,000 to charity each year. Last year, they were in the 39.6% tax bracket, so the after-tax cost of their donations was $6,040. This year, they find themselves in the 35% bracket, increasing the after-tax cost to $6,500.

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Standard deduction raised, itemized deductions limited

The TCJA's changes to standard and itemized deductions also increase the cost of charitable giving. It nearly doubles the standard deduction to $12,000 for individuals and $24,000 for married couples filing jointly. In addition, it:

- Eliminates most itemized deductions, although it retains the write-offs for charitable contributions and certain other expenses,
- Limits deductions for state and local taxes to $10,000,
- Limits deductions for new mortgages to interest on up to $750,000 of indebtedness (down from $1 million), and
- Eliminates, in certain circumstances, the deduction for interest on up to $100,000 of home equity debt.

Charitable IRA rollover: No need to itemize

If you're age 70½ or older and plan to make charitable gifts, consider a qualified charitable distribution (QCD) from an IRA — also known as a "charitable IRA rollover." This strategy allows you to transfer up to $100,000 per year directly from an IRA to a qualified charity, tax-free, and to apply that amount toward any required minimum distributions (RMDs) for the year. Because the funds aren't included in your income, it's the equivalent of a $100,000 charitable deduction, without the need to itemize.

The QCD is an option for people who otherwise wouldn't be entitled to a deduction, because they claim the standard deduction or because their deductions are reduced by AGI limitations.

These changes mean that many more taxpayers will be taking the standard deduction rather than itemizing, which eliminates the tax benefits of charitable giving. For example, let's say a married couple has $7,000 in deductible mortgage interest expense, is limited to $10,000 in deductions for state and local taxes, and has no deductible medical expenses. The $24,000 standard deduction means they'll receive no tax benefit on their first $7,000 in charitable donations.

Planning tip: Bunch charitable deductions

One way to boost the tax benefits of charitable giving is to "bunch" your donations into alternating years. Suppose the couple in the example above ordinarily donates $6,000 per year to charity. They can enjoy additional tax savings by donating $12,000 every other year instead. So, for example, they might claim the standard deduction ($24,000) this year and take $29,000 in itemized deductions next year ($10,000 in state and local taxes, $7,000 in mortgage interest and $12,000 in charitable donations). This strategy generates an additional $5,000 in deductions over a two-year period.

If you *do* itemize, keep in mind that the TCJA increases the limit for *cash* gifts to public charities and certain private foundations from 50% to 60% of your contribution base — generally, adjusted gross income (AGI). Other contributions continue to be limited to 50%, 30% or 20% of AGI, depending on the type of property donated and the type of charitable organization. As before, excess contributions may be carried forward up to five years.

No deduction for college sports

The TCJA also eliminates deductions for donations to colleges and universities in exchange for the right to purchase season tickets to athletic events. Previously, these donations were 80% deductible.

Estate tax exemption doubled

The TCJA doubles the gift and estate tax exemption for deaths and gifts after December 31, 2017, and before January 1, 2026. In 2018, the inflation-adjusted exemption is $11.18 million ($22.36 million for married couples). With only 2,000 or so families in the U.S. now subject to estate tax, the vast majority of taxpayers won't benefit from charitable vehicles, such as charitable remainder trusts, designed to reduce estate taxes.

Should charities be worried?

A number of not-for-profit organizations opposed the TCJA, fearing it would "devastate" charitable giving. But even though several of the TCJA's provisions increase the after-tax cost of charitable donations, they're also expected to reduce most individuals' tax bills, at least during the first eight years. Many commentators believe that lower taxes combined with anticipated economic growth will spur an *increase* in charitable giving. This view is consistent with studies showing that charitable giving in the United States consistently falls at around 2% of disposable income.

The same goes for charitable giving at death. Even though the tax incentives associated with charitable bequests have been eliminated for most people, the doubling of the estate tax exemption means many people will have more money available to give away.

Revisit your charitable giving plan

If you're charitably inclined, now's the time to review your plan to assess the TCJA's impact. Knowing the price of your gifts will help you determine whether any adjustments are necessary or desirable. ■

Are you personally liable for your company's payroll taxes?

When a business fails to remit payroll taxes, the IRS has the authority to collect those taxes from "responsible persons," including certain shareholders, partners, officers and employees. The IRS takes an expansive view of who constitutes a responsible person.

Definition of a responsible person

In this context, a "responsible person" includes anyone — within or outside the company — with significant control or influence over the company's finances. This control or influence can be derived from an ownership interest, job title, check-signing authority, hiring or firing authority, control over the company's payroll, or power to make federal tax deposits.

The IRS is also liberal in its interpretation of the term "willfully." It includes not only those who intentionally fail to remit payroll taxes, but also those who "recklessly disregard" obvious or known risks of nonpayment. The IRS won't impose trust fund penalties, however, on a responsible person who's negligently unaware of a payroll tax default.

It's important to understand that you can't avoid liability for trust fund penalties by delegating payroll tax responsibilities to someone else, whether it's another employee or owner or a third party, such as a payroll service provider. They may *also* be responsible persons, but relying on them doesn't mean you're off the hook. (See the discussion of CPEOs on page 5.)

A case in point

A recent case demonstrates the lengths that the IRS will go to in order to collect unpaid payroll taxes. In *Shaffran v. Commissioner*, the IRS assessed more than $70,000 in trust fund penalties against a 77-year-old man whose only connection to a business (a restaurant co-managed by his son and the restaurant's owner) was that he'd signed a few checks for the business when neither manager was available.

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Shaffran visited the restaurant two or three times per week for several hours, where he "sat around" at the bar and occasionally acted as a "gofer" for the managers. He occasionally prepared checks for his son to sign and he signed four checks (two for suppliers and two for loan payments) when the managers were unavailable. The bank honored the checks even though Shaffran was not an authorized signatory on the account.

The U.S. Tax Court ultimately concluded that Shaffran's activities and authority didn't rise to the level of a responsible person. Nevertheless, he was forced to invest time and money to prove his lack of responsibility and to endure the stress of litigation with the IRS.

Consider a CPEO

Many businesses use professional employment organizations (PEOs) to handle a variety of employment-related tasks, including collecting and remitting payroll taxes. Contrary to popular belief, however, using a PEO doesn't relieve a business or its responsible persons from liability for unpaid payroll taxes. But a business may avoid liability by using a *certified* PEO (CPEO). Because a CPEO is treated as the employer of its customers' workers, it retains sole responsibility for all related payroll tax obligations. Contact your advisor to help determine if a CPEO is right for your company. ■

Gain flexibility with a self-directed IRA

Traditional and Roth IRAs are considered relatively "safe" retirement-savings vehicles, but a drawback to them is that they limit your investment choices. A self-directed IRA gives you more flexibility in your investment choices with potentially greater returns, including real estate, precious metals, energy and other alternative investments. On the downside, self-directed IRAs are riskier and can lead to unfavorable tax consequences. Let's take a closer look at how this retirement-savings vehicle might affect your estate plan.

IRAs and your estate plan

IRAs are designed primarily as retirement-saving tools, but if you don't need the funds for retirement, they can provide a tax-advantaged source of wealth for your family. For example, if you name your spouse as beneficiary, your spouse can roll the funds over into his or her own IRA after you die, enabling the funds to continue growing on a tax-deferred basis (tax-free in the case of a Roth IRA).

If you name a child (or someone other than your spouse) as beneficiary, that person will have to begin taking distributions immediately. But if the funds are held in an "inherited IRA," your beneficiary can stretch the distributions over his or her own life expectancy, maximizing the IRA's tax benefits.

Defining a self-directed IRA

A self-directed IRA is simply an IRA that gives you complete control over investment decisions.

Traditional IRAs typically offer a selection of stocks, bonds and mutual funds. Self-directed IRAs (available at certain financial institutions) offer greater diversification and potentially higher returns by permitting you to select virtually any type of investment, including real estate, closely held stock, limited liability company and partnership interests, loans, precious metals, and commodities (such as lumber and oil and gas).

A self-directed IRA can be a traditional or Roth IRA, a Simplified Employee Pension (SEP) plan, or a Savings Incentive Match Plan for Employees (SIMPLE). It's also possible to have a self-directed individual 401(k) plan, Health Savings Account or Coverdell Education Savings Account.

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Self-directed IRAs offer the same estate planning benefits as traditional IRAs, but they allow you to transfer virtually any type of asset to your heirs in a tax-advantaged manner. Self-directed Roth IRAs are particularly powerful estate planning tools, because they offer tax-*free* investment growth. In addition, Roth IRAs aren't subject to required minimum distribution (RMD) rules, so you can keep them fully funded beyond age 70½, leaving more for your beneficiaries.

Navigating the tax traps

To avoid pitfalls that can lead to unwanted tax consequences, caution is required when using self-directed IRAs. The most dangerous traps are the prohibited transaction rules. These rules are designed to limit dealings between an IRA and "disqualified persons," including account holders, certain members of account holders' families, businesses controlled by account holders or their families, and certain IRA advisors or service providers. Among other things, disqualified persons may not sell property or lend money to the IRA, buy property from the IRA, provide goods or services to the IRA, guarantee a loan to the IRA, pledge IRA assets as security for a loan, receive compensation from the IRA or personally use IRA assets.

The penalty for engaging in a prohibited transaction is severe: The IRA is disqualified and all of its assets are deemed to have been distributed on the first day of the year in which the transaction takes place, subject to income taxes and, potentially, penalties. This makes it virtually impossible to manage a business, real estate or other investments held in a self-directed IRA. So, unless you're prepared to accept a purely passive role with respect to the IRA's assets, this strategy isn't for you.

Is a self-directed IRA right for you?

If you have unique assets, such as precious metals, energy or other alternative investments, a self-directed IRA may be worth your while to consider. However, it's important to consult your advisor to weigh the potential benefits against the risks. ■

Small businesses: Consider an HRA

Under legislation passed in late 2016, qualifying small businesses (those with fewer than 50 full-time or full-time-equivalent employees) are permitted to use Health Reimbursement Arrangements (HRAs) without running afoul of the Affordable Care Act. A cost-effective alternative to group health insurance, HRAs are employer-funded plans that use pretax dollars to reimburse employees for out-of-pocket medical expenses and individual health insurance premiums.

Late last year, the IRS issued Notice 2017-67, providing guidance on the eligibility requirements and tax implications of these Qualified Small Employer Health Reimbursement Arrangements (QSEHRAs). Among other things, reimbursements from QSEHRAs are nontaxable to employees provided they maintain "minimum essential coverage." ■

Alimony deduction is coming to an end

The Tax Cuts and Jobs Act (TCJA) eliminates the tax deduction for qualified alimony payments, effective for divorce decrees or separation agreements issued or executed *after* December 31, 2018. It won't affect existing arrangements or arrangements finalized before the end of 2018.

Currently, alimony payments are deductible by the payer and included in the recipient's taxable income. This makes it possible to shift income from the payer, who is typically in a higher tax bracket, to the recipient, who is usually in a lower tax bracket. Once the deduction is eliminated, payments will no longer be deductible by the payer or taxable to the recipient.

These changes provide divorcing couples with an incentive to finalize their proceedings by the end of this year. Some alimony recipients may be tempted to delay their divorces until next year, when the payments are no longer taxable. But the deduction can be advantageous to *both* parties, because it minimizes their combined income tax, making more after-tax income available for division. ■

Beware the "kiddie" tax

At one time years ago, parents could substantially reduce their families' overall tax burden by shifting income to children in lower tax brackets (usually by transferring investments or other income-producing assets). The kiddie tax was designed to discourage this strategy by taxing most of a dependent child's unearned income at the *parents'* marginal rate. The tax applies to children age 18 or younger plus full-time students age 19 to 23 (with certain exceptions).

Under the TCJA, the kiddie tax is imposed according to the rates applied to *trust* income. The trust tax brackets are compressed, so that the highest marginal rate (currently 37%) kicks in when taxable income exceeds $12,500. In contrast, for a married couple filing jointly, the top bracket begins at $600,000 of taxable income. The impact of this change will depend on a family's particular circumstances. In general, it will reduce the cost of the kiddie tax for relatively small amounts of unearned income, but many families will find that the top kiddie tax rate is now *higher* than the parents' marginal rate. ■

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