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## August Monthly Newsletter

2018

### Important Reminders

#### **Sales tax 'holiday returns August 3rd-5th**

Ohio will observe its now-annual sales tax "holiday" Aug. 3-5.

The following items are exempt from sales and use tax during that weekend:

- Clothing priced at \$75 per item or less;
- School supplies priced at \$20 per item or less; and
- School instructional material priced at \$20 per item or less.

Items used in a trade or business are not exempt under the sales tax "holiday."

OSCPA members are encouraged to celebrate responsibly. For more information, visit [www.tax.ohio.gov](http://www.tax.ohio.gov)

Summer is in full swing and the air conditioners are working overtime. Hopefully you are finding ways to stay cool while enjoying your outdoor activities. Included in this newsletter are articles about a new tax trap created by student loan forgiveness, tips to improve your financial situation and ideas to ensure that you are not sharing too much online. For your business, there are articles explaining "economic nexus" for sales tax and best practices for setting up your accounting system. Lastly, there are tips to help you manage your capital gains taxes.

Should you wish to review your situation please feel free to call. Also feel free to forward this newsletter to someone who may benefit.

### Student Loan Forgiveness Creates New Tax Trap

There's a new student loan repayment program that forgives some student loan debt if other payments are made. This new debt forgiveness is creating a tax surprise for the unsuspecting student. Here is what you need to know.



### The debt forgiveness program dilemma

To combat the hardship of high student loan debt, a popular new repayment option is the income-based repayment plan. These plans limit monthly payment amounts to a percentage of discretionary income. They also limit the number of repayment years. If your loan is not paid by a pre-determined future date and you've been making the payments as agreed, the balance of the loan is forgiven.

While the prospect of having a portion of the debt canceled is enticing, it can create an unexpected tax burden if you are not prepared. Here's why it may be a problem:

- **Canceled debt is considered taxable income.** When a portion of a loan is forgiven, that amount is considered taxable income in the year in which the debt is cancelled. While there are exceptions, this is the general tax rule.
- **A 1099-C is issued to you and the IRS.** Upon the forgiveness of the student loan debt, the loan servicing company will issue a Form 1099-C titled "Cancellation of Debt". A copy of the form will be delivered to both you and the IRS informing both parties of the amount of forgiven debt. This amount needs to be included on your Form 1040.
- **Taxes are due at filing.** The entire amount will likely be taxed at the taxpayer's highest marginal tax rate. This amount is due in its entirety at the annual tax-filing deadline. If a large amount is due, there may also be additional underpayment fees tacked on by the IRS.

### *Some exceptions apply*

Before you begin to worry about a surprise tax bill, consider your other options:

- **Tax-exempt debt forgiveness programs:** There are a few programs that consider the student loan canceled debt tax-exempt. The two most common are for students that become public service employees and teachers. So when you have canceled debt, conduct a review to see if your employment complies with the possible tax exclusion.
- **Insolvency exclusion:** The IRS provides a way to exclude a forgiven debt from taxable income if you can prove you are financially insolvent. The IRS defines "insolvency" as when a taxpayer's total liabilities exceed his or her total assets. To claim this exclusion, an additional form is filed with your tax return. Make sure you can back up any claims you make, because the IRS may request to see proof.
- **IRS repayment plan:** If you have a balance due as a result of the canceled debt and cannot pay it in full by the deadline, the IRS has payment plans available. There will be additional penalties, interest and possibly setup fees that will be added to the amount due. This is not a great option, but it is better than not paying the balance at all.



Even with the additional tax liability that is realized, debt relief is generally a good deal for most. The hardship comes if you are not prepared for how to handle the tax payment that becomes due. Before signing an agreement that relieves debt, it makes sense to review your situation to avoid any surprises on your tax bill.

### Ideas to Improve Your Financial Health

No-one likes to be blindsided by financial hardship. Listed here are 10 ideas to help ensure your financial situation stays healthy.

- **Create a safety net.** Plan to have a minimum savings balance to cover at least three months' of expenses (ideally, this should be six to 12 months). If your reserves are light, start saving now. Even if it is a little amount, it can get you on the right track.
- **Develop a budget.** At least once a year develop a basic budget. Set goals and try to hit them. If this seems overwhelming, start simple. What is coming in and what goes out each month? Becoming aware is the first step to improving your financial health.
- **Make your spouse a financial partner.** If you die, does your significant other know where everything is? Can he/she pay the bills? Does he know where account numbers are? Does your spouse know who you use to help with things? If not, it is time to start talking.
- **Review your beneficiaries.** Once a year review beneficiaries on all accounts. This includes retirement accounts as well as names on wills and estate plans. The legal hassle created without this review can be devastating to your surviving family. This is especially important if you had a recent life event (marriage, divorce, birth or death).
- **Maximize your benefits.** Make sure you review your retirement plans to maximize any employer match in your account. Also review your plan's administrative expenses. If they are too high they can cost you thousands of dollars over your lifetime.
- **Create a disaster plan.** If your home burned down or was flooded, are your important records easily accessible and protected? If not, consider creating a disaster plan. This may include placing important documents in a safe deposit box in another location than your home.
- **Review your credit report.** With the recent increase in identity fraud, plan to check your credit with the major credit agencies once a year. The agencies are legally required to make their report available to you annually without charge.
- **Review your insurance plans.** Periodically look at your health, life, home and liability insurance. With the legal nature of our society, you might consider the need for an umbrella policy to cover against potential litigation. But also consider flood insurance and a replacement value homeowner's policy.



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- **Manage your debt.** Review your use of credit cards, loans, etc. Understand your net worth (assets minus liabilities). Make progress in reducing your debt load starting with the highest interest obligations first. Is your debt lower than it was last year?
- **Plan for fun.** Just because you are taking steps to improve your financial situation doesn't mean that you can't have fun. Be smart about your entertainment spending. If you are planning a vacation, research money-conscience options and have a budget that fits in with your other financial goals.

This list is by no means complete, but if you focus on the areas mentioned, your financial life will become more planned and less likely to be struck by an unforeseen surprise.

### Dramatic Sales Tax Change

The U.S. Supreme Court issued a ruling in the South Dakota vs Wayfair case that opens the door for states to impose sales tax on sellers outside their borders. The case highlights a new standard of business presence called "economic nexus" that may have major implications for businesses and consumers alike.

#### **Economic nexus explained**

The exact definition varies, but in general, economic nexus makes a connection between a taxing authority (usually a state) and a seller based on certain sales or transaction levels. The Supreme Court agrees with South Dakota that having economic presence is enough to require an out-of-state retailer to register with the state to collect and remit sales tax. For example, the state of South Dakota mandates that if a retailer has \$100,000 in annual in-state sales or has 200 separate in-state sales transactions over the previous 12 months, they must collect sales tax on all sales in South Dakota.

#### **What it means for businesses**

- **New, lower threshold for tax exposure:** Sales tax nexus was mostly determined by physical presence. If a business has an office or employee located in a state, they likely were required to collect tax on sales in that state. The economic nexus standard removes the physical presence requirement with this ruling. Businesses now may need to compare sales-by-state data to the individual state economic nexus laws to determine whether they have a sales tax obligation in that state.
- **More tax registrations & filings:** Businesses that sell outside their state may need to register in many more states – maybe all 50. With more registrations come more compliance management and more sales tax returns that need to be filed on an ongoing basis. The impact on workload for sales tax staffs could be huge.



- **Increased audit potential:** With each new state registration comes a new potential audit authority. Sales tax audits almost always bring in additional revenue for states, so they will be looking to capitalize on the increased registrations. Sales tax compliance management is more important than ever and could lead to state income tax changes.

### What's next?

As many as 16 states have economic nexus laws in place to try to take advantage of the new ruling, with many more to introduce legislation. By nature, Internet retailers will be hit the hardest and are expected to lobby in states that have not passed economic nexus laws. In addition, it will take states some time to get their systems updated to handle the new laws and increased filings. While there might be some short-term delays during implementation, sales tax changes appear to be on their way.

### [Are you Sharing Too Much Information Online?](#)

In today's digital age, it is impossible to avoid the internet. Even if you don't have a computer and actively avoid social media, there is information about you in some corner of the web. Here are some tips to help you manage your digital footprint:

- **Actively manage your security settings.** Every app, social media site and web browser have multiple layers of privacy and security settings. When you download a new app or register with a new site, don't simply trust the default settings. Look through the options yourself to ensure you are comfortable with the level of privacy. One thing to watch for with apps on your phone is location settings. Some apps will track your location even when the app isn't running.
- **Protect your online image.** Career search firms now have strategies built entirely around recruiting through social media. According to LinkedIn, more than 20,000 companies use their platform to attract new talent. In addition to recruiting, human resource departments will vet prospective employees by reviewing social media profiles.

What you share and how you portray yourself on social media is extremely important to your career. Pay attention to what others post about you, as well. If you are uncomfortable with what they are sharing, have a conversation with them and ask that it be taken down.

- **Set boundaries for yourself.** According to the Pew Research Center, 74 percent of Facebook users visit the site on a daily basis. And 51 percent say they visit multiple times per day. Try to find the balance that allows you to enjoy connecting with others online, but doesn't negatively impact other parts of your life.

In addition to time spent, draw a bright line between what you consider shareable versus personal information. If you have these boundaries in mind when on social media, it will help you think critically before continuing to scroll or posting something.



- **Know your friends.** Having friends is fun. Having the wrong friends can be harmful and even dangerous. If you receive a friend request from someone you don't know, deny it. They might simply be trying to increase their friend count, but they could be looking to access personal data. Review your friends on every platform on a periodic basis, and don't fret about how many friends you have. Quality is much more important than quantity.

The best defense of your private information is you. Having a plan and actively managing your online profiles is the best way to minimize the chance of your personal data falling into the wrong hands.

### Setting up Your Business Accounting System

You've done the hard work. You have a new business idea or you've found an existing business to purchase. Want to help ensure your business success? Pay attention to correctly setting up your business' accounting system. Here's how:

- **Consider business entity.** Choosing the right legal and tax entity for your business is important. Consult experts to discuss your options. On the tax side, sole proprietors use a Form 1040 Schedule C to report their activity, while other business entities such as S-Corporations and Partnerships file informational returns and pass-through profits to your individual tax return. C-Corporations require separate tax returns without pass-through of profits onto your personal tax return.
- **Determine if you'll use cash versus accrual basis.** There are different approved methods of accounting. You will need to determine which is best for you. Sometimes your business dictates a required method, but not always. The basic difference lies in when you can book revenue and expense. One method (cash) is based upon when you actually receive or make payment. While the accrual method allows capturing this same information when there is an established obligation.
- **Separate your books.** If starting a business from scratch, remember to set up separate bank accounts and recordkeeping. IRS auditors are quick to disallow expenses when your business expenses are mingled together with personal expenses. The same is true with credit cards. Use a separate credit card for your business transactions.
- **Use sub-ledgers.** Well-run businesses understand the need to organize elements of their business into accounting categories. These categories often use their own reporting system called sub-ledgers. Common areas are sales, accounts receivable, accounts payable, fixed assets, and inventory.
- **Honor cash flow.** Often success or failure of your business is predicated on whether you have enough cash to pay your bills. Determining your cash needs means understanding the cash situation of your business. To do this requires a good set of records. This includes recording your current situation on a timely basis and establishing a forecast of cash needs throughout the year.



- **Create a fortress balance sheet.** Banks love a strong balance sheet. If you think your business may need money for expansion, you will want to focus on developing a strong balance sheet that is low in debt and high in liquid assets like cash and accounts receivable. The irony here is that it's easy to borrow money when your records show you don't need it and it's hard to borrow money when you do need the funds.
- **Identify financial pressure points.** Every business has a few financial items that drive profitability. Do you know yours? It might be payroll in a labor-intensive business. It might be rent in a retail establishment. Perhaps your margins are low because of heavy promotional costs. A strong accounting system will help you stay focused on the more important financial elements of your business.
- **Understand seasonality.** By setting up a good accounting system AND forecasting performance over a twelve-month period, you will understand the true needs of your business. This is especially important if your business is seasonal in nature.

Remember, by spending time setting up the accounting system that is right for you, you are increasing your business' chance for success.

### Manage Capital Gains Tax Tips

If not tracked and managed properly, capital gains tax can come as a large surprise at tax-filing time. In fact, many taxpayers don't realize they have a capital gain until they get their 1099 form in January and see a capital gain distribution. Here's what you need to know.

#### **Understand capital gains and their taxability**

Capital gains are recognized when you sell a capital asset for more than your basis in that asset. Capital assets are typically something of value like your home, a car and other investments. Basis is typically the original cost of the asset being sold. The difference between the sales price of the asset and your basis is the amount of the taxable capital gain.

The IRS taxes short-term capital gains for assets owned less than one year as ordinary income up to 37 percent, but taxes long-term capital gains at a maximum 23.8 percent (20 percent plus a potential 3.8 percent net investment tax).

#### **Ways to manage capital gains tax**



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- **Hold investments for more than one year.** Long-term gains (assets sold more than a year after acquisition) are taxed at the lower capital gains rate. If you are able to hold assets for more than a year, you will save tax dollars by avoiding the gain being classified as ordinary income.
- **Sell large gains in low-income years.** If you expect lower income this year, it might be a good time to sell some of your capital gain investments. Since the capital gains tax brackets follow the marginal income tax brackets, if you are in a lower income tax bracket in a given year you may pay a lower capital gains tax. You can take advantage of this with both long-term and short-term gains.
- **Harvest large losses in high-income years.** If you have a high-income year you can save taxes by selling investments that have lost money. Capital losses help reduce your capital gains with the tax liability calculated on the net amount. Be aware of IRS netting rules that require you to net long-term losses with long-term gains and short-term losses with short-term gains. If one results in a net loss and the other a net gain, they are then netted against each other. If the final amount results in a net loss, the most you can deduct against ordinary income in one year is \$3,000. The excess losses must then be carried forward to future tax years.
- **Gift your investments to your kids.** You are allowed to gift up to \$15,000 per year to each of your kids (\$30,000 per married couple). If you gift appreciated investments to a child under 19 and they then sell that investment, each child can receive favorable tax treatment on up to \$2,100 from their taxes. Be careful if you go over the annual exemption. Higher levels of unearned income for children, including capital gains, is now subject to estate and trust tax rates.
- **Consider donating property.** If you donate appreciated property to a qualified charity you can deduct the donation as an itemized deduction. Even better, if the property is owned by you for more than one year, you can deduct the current market value without being subject to capital gain tax.
- **Sale of primary residence exclusion.** If you sell your home, you may qualify to exclude \$250,000 of the gain from capital gains tax (\$500,000 if married filing jointly). In order to qualify, you need to own the home and have occupied the home as your primary residence for at least two of the previous five years. The two years do not need to be simultaneous.

There are many factors that come into play when buying or selling an asset. Just make sure the tax implications are considered before you make the transaction.

As always, should you have any questions or concerns regarding your situation please feel free to call.



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