CPA

Client Bulletin

DAVIE KAPLAN
Certified Public Accountants

Smart tax, business and planning ideas **from your** Trusted Business Advisor℠

June 2018

IRS okays home equity deductions

As previously reported in the April 2018 edition of the *CPA Client Bulletin*, the Tax Cuts and Jobs Act of 2017 affected the tax deduction for interest paid on home equity debt as of 2018. Under prior law, you could deduct interest on up to $100,000 of home equity debt, no matter how you used the money. The old rule is scheduled to return in 2026.

The bad news is that you now cannot deduct interest on home equity loans or home equity lines of credit if you use the money for college bills, medical expenses, paying down credit card debt, and so on. The good news is that the IRS has announced "Interest on Home Equity Loans Often Still Deductible Under New Law." The details are in IR 2018-32, a news release from the IRS.

The book, not the cover

According to the IRS, even if a loan is labeled "home equity," the interest may be deductible on your tax return. The key is how the borrowed money is used. In addition, the $100,000 ceiling doesn't apply.

For home loan interest to be tax deductible, the taxpayer that secures the loan must use the money to buy, build, or substantially improve his or her home. Beginning in 2018, taxpayers may only deduct interest on $750,000 of such "qualified residence loans," or $375,000 for a married taxpayer filing separately.

Those numbers apply to the total of a taxpayer's home loans, but older loans up to $1 million and $500,000, respectively, may have fully deductible interest. As before, home loan interest on debt that exceeds the cost of the home won't be eligible for an interest deduction, among other requirements.

Fine points

For home loans obtained in 2018 and future years, some tax rules are clear, but some are more complex.

Example 1: Eve Harper gets a $500,000 loan from Main Street Bank to buy a home in July 2018. In November 2018, Eve gets a $50,000 "home equity" loan from Broad Street Bank, which she uses to buy a car. The interest on the second loan is not tax deductible.

Example 2: Same as example 1, except that Eve uses the Broad Street Bank loan to install central air conditioning, add a powder room, and upgrade plumbing throughout her new home. The interest on both of these loans will be deductible.

In this issue

1 IRS okays home equity deductions

2 Buck market volatility with a retirement bucket plan

3 Coping with summer vacations at your small business

4 Tax calendar

Winning streak

The median U.S. house price reached $241,700 in early 2018, marking 72 consecutive months of year-on-year price gains.

continued on next page →

Trusted advice

Secured debt

- Home loan interest is deductible, up to the applicable limit, only if the obligation is a secured debt.
- You must sign an instrument, such as a mortgage, deed of trust, or land contract, that makes your ownership interest in a qualified home security for payment of the debt.
- A *qualified home* includes a house, condominium, mobile home, boat, or house trailer with sleeping, cooking, and toilet facilities that is your main home or second home.
- In case of default, the home used as security can satisfy the debt.
- This arrangement must be recorded or otherwise officially noted under the relevant state or local law.

The tax treatment of these examples may seem straightforward, but that's not always true.

Example 3: Same as example 1, except that the Broad Street Bank loan is used to make a down payment on a mountain cabin, where Eve plans to go for vacations. Interest on this $50,000 loan is deductible because the total of both loans does not exceed $750,000, and the $50,000 loan is secured by the cabin. Indeed, Eve could get a loan up to $250,000 (for a $750,000 total of home loans) to buy the cabin and still deduct the interest, as long as this loan is secured by the cabin.

Example 4: Same as example 3, except that the Broad Street Bank loan is secured by Eve's main home, not by the cabin she's buying. Now, the Broad Street Bank loan would be considered home equity debt no matter how much was borrowed, and no interest on that loan could be deducted.

Over the limit

What would happen if Eve gets a $500,000 loan in June to buy her main house and another $500,000 loan in November to buy a vacation home? She would be over the $750,000 debt limit for deducting interest on 2018 home loans, so only a percentage of the interest paid would be tax deductible.

The bottom line is that if you intend to use a home equity loan to buy, build, or substantially improve a home, you should be careful about how the debt is secured. Be prepared to show that the money really was used for qualified purposes.

Moreover, qualified home loans obtained on or before December 15, 2017, are grandfathered, with tax deductions allowed for interest up to $1 million or $500,000, as explained. Some questions remain, though, about how refinancing those grandfathered loans will affect the tax treatment. If you are considering refinancing a home loan that's now grandfathered, our office can provide the latest guidance on how your taxes might be affected.

Buck market volatility with a retirement bucket plan

We have seen an increase in market volatility in early 2018. A steep pullback in stocks could be good news for working people who are building retirement funds, but those approaching or recently beginning retirement might be hurt.

Historically, stock market setbacks have proven to be buying opportunities for patient investors.

Example 1: Harry Walker was 50 years old in 2008, with most of his retirement savings invested in stock funds within his 401(k) account. Then, Harry's holdings dropped heavily.

Harry stayed the course and continued to buy stock funds as the Dow Jones Industrial Average (DJIA) rebounded from a 2008 low around 7,500 to 10,000 in 2009, 11,000 in 2010, and so on. Therefore, Harry has built substantial wealth, with the DJIA around 24,000 as of this writing.

Vulnerable to volatility

Ten years later, Harry's situation is different.

Example 2: Harry is age 60 now, with $1 million in his 401(k). He plans to retire at 62, but a stock market collapse could trigger a 40% drop, reducing his $1 million 401(k) to $600,000. Harry might have to postpone his retirement or reduce the amount he withdraws from a smaller portfolio. If Harry stops working, he

Did you know?

In 2017, total U.S. household consumer debt reached $13 trillion. Non-mortgage debt (car loans, student loans, credit cards, and so on) was reported by 71% of American workers. Only 31% of workers with non-mortgage debt were saving outside the workplace for retirement, compared with 69% of workers without non-mortgage debt.

Source: LIMRA Secure Retirement Institute.

continued on next page →

may not be able to keep investing and profit again from any market rebound.

Harry could avoid this potential problem by moving his 401(k) account from stock funds into cash. However, yields on bank accounts and the like are extremely low. If Harry moves out of stocks at age 60, he'll avoid market risk but also reduce his opportunity for substantial investment growth going forward.

Going for the flow

Instead of moving 100% to cash, Harry could implement a so-called "bucket plan." These plans vary, but the key to success is to have a substantial cash bucket. Continuing our example, Harry Walker would figure out how much money he'll need for living expenses each month from his portfolio after he stops working. Typically, a cash bucket will hold at least a year's worth of cash flow.

Example 3: Harry calculates that he'll need $4,000 a month from his 401(k) or from an IRA after a rollover to maintain a desired lifestyle. If Harry needs to take $4,000 a month from his retirement plan, he would hold at least $48,000 in his cash bucket at the start of retirement with this strategy. From the cash bucket, Harry would arrange to have $4,000 paid into his checking account each month, just as his paychecks from work were handled.

Regular refills

Setting up the cash bucket is just the beginning of a bucket plan. That bucket must be replenished so cash can keep flowing.

One way to do this is to divide portfolio assets into two broad categories: fixed income (mainly bonds) and equities (mainly stocks). At regular intervals, money can flow from the fixed income bucket into the cash bucket and from the equities bucket into the fixed income bucket. This allows stocks to be held for the long term, which, historically, has been a winning investment strategy.

Other bucket plan strategies can be used. If this method appeals to you as a way to address possible market volatility, our office can go over your plan to illustrate how various portfolio assets can be delivered to you as after-tax cash flow.

Coping with summer vacations at your small business

During the summer, it may be true that "the living is easy," as the old song goes. The midyear season, though, is often not so easy at small businesses because many employees are taking vacations. Total work hours often shrink and so may company productivity.

Spreading vacation time over the rest of the year might not be practical, especially if many of your workers have school-age children and desire family vacations during summer break. You may prefer to squeeze most vacations into the summer so the disruption is minimal the remainder of the year. Nevertheless, you probably won't welcome a warm weather slowdown, so it's best to take steps to keep things running at an acceptable pace.

Scheduling strategies

It's vital to create and maintain a visual schedule of who is taking time off and when. This might be created with a simple wall board or online. In a relatively small company, you could have your assistant keep up this schedule and show it to you every week or so. A larger firm could leave the schedule supervision to department or division heads, each of whom would track their workers.

However you decide to do it, you should have an easy way to see who will be away next week, the week after, and so on. If several people are scheduled for vacations during, say, the third week of July, you (or the manager who will be affected) might push forward some projects or delay them until you have a full crew in the office. Also, you probably should be cautious about approving additional vacation requests for weeks when multiple employees are already planning time off.

Reaching out

Summer vacations can be extra troubling because your business won't be the only one shorthanded from now until Labor Day. Chances are that your customers, suppliers, and other companies with which you work also will have employees who won't be available. Their absence can put a crimp in your own operations. If you have strong relationships with such business associates, you might ask about their vacation schedules and who to contact if your company runs into a snag.

In some situations, you might decide to revise some of your company's efforts to make the timing mesh with that of key outsiders.

Filling the gaps

There is not much you can do about vacationing employees elsewhere, but there are things you can do this summer to help your company manage with a reduced workforce. If there are deadlines, require employees to finish all projects before they leave. For ongoing efforts, have your workers write up a summary of work-to-date with helpful materials attached. Get

continued on next page →

mobile numbers and email addresses where they can be reached, in case a need for contact should arise.

Make sure employees place vacation responses on their work phones and email, with dates of departures and returns. You might consider assigning someone to create templates for these employees to use for their vacation responses; this can assure that vacation responses will contain the required information and without any comments that could offend or reveal confidential matters.

In addition, arrange for some employees to cover for those on vacation, if necessary. You're probably better off if you can avoid one-on-one coverage because the worker staying at the office will be doing two jobs. Work sharing among multiple co-workers might be a better solution. If you have summer interns, ask if they might be able to handle some of the tasks usually assigned to the vacationers.

Clarity begins at home

With all this planning, don't forget to schedule your own vacation. Obviously, you also work hard throughout the year, so some downtime will be beneficial, whether you travel or wind down at home.

In addition, you should keep track of what unexpected flaws arise this vacation season and how you might remedy them in 2019. Should you require all summer vacation requests two weeks, or even a month, ahead of time? Demand that all requests be turned in by Memorial Day before you grant any approvals? Treat conflicts in favor of seniority? Offer those who lose out by conflict a chance to jump the line next year? The more clarity in a vacation plan you disseminate to all employees, the greater the chance your company will keep operating at its peak this summer and next.

Tax calendar

JUNE 2018

June 15

Individuals. If you are not paying your 2018 income tax through withholding (or will not pay enough tax during the year that way), pay the second installment of your 2018 estimated tax.

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due for 2017. If you want additional time to file your return, file Form 4868 to obtain four additional months to file. Then, file Form 1040 by October 15.

Corporations. Deposit the second installment of estimated tax for 2018.

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

JULY 2018

July 16

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

July 31

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the second quarter of 2018. Deposit any undeposited tax. If your tax liability is less than $2,500, you can pay it in full with a timely filed return. If you deposited the tax for the quarter in full and on time, you have until August 10 to file the return.

For federal unemployment tax, deposit the tax owed through June if more than $500.

If you maintain an employee benefit plan with a calendar year-end, file Form 5500 or 5500-EZ for calendar year 2017.

Association of International Certified Professional Accountants®

The unified voice of AICPA and CIMA

The *CPA Client Bulletin* (ISSN 1942-7271) is prepared for the clients of AICPA members and other practitioners. The Bulletin carries no official authority, and its contents should not be acted upon without professional advice. Printed in the U.S.A. Sidney Kess, CPA, JD, Editor. For AICPA customer service, call 888.777.7077 or visit aicpastore.com.

© 2018 Association of International Certified Professional Accountants. All rights reserved. AICPA and American Institute of CPAs are trademarks of the American Institute of Certified Public Accountants and are registered in the United States, European Union, and other countries. The Globe Design is a trademark owned by the Association of International Certified Professional Accountants and licensed to the AICPA.