MANAGEMENT & TAX CONCEPTS

WINTER 2019

WHY YOU ABSOLUTELY NEED A LAST WILL AND TESTAMENT

MORE IN THIS ISSUE...

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Why you absolutely need a last will and testament

It's the simplest and most basic step you can take as part of the estate planning process: creating a last will and testament. So, it's somewhat surprising that fewer than half of all Americans — just 44% — have done so.

This was the result of a Gallup poll that was conducted in 2016 shortly after the passing of the entertainer Prince, who died without a will. More recently, the Queen of Soul, Aretha Franklin, also reportedly died without a will.

Bob Marley, Kurt Cobain and Jimi Hendrix were other wealthy entertainers who didn't prepare a last will and testament before passing away. In some of these high-profile cases, the decedents' heirs battled in court for decades over the rights to assets in the entertainers' estates.

SIMPLIFYING YOUR ESTATE SETTLEMENT

You probably aren't a famous entertainer with a multimillion-dollar estate. But this doesn't make drafting a last will and testament less important. By creating a will detailing how your assets should be distributed, you'll simplify the estate settlement process for your loved ones.

If you die without a will, your assets will go through the probate process. A judge will make decisions about how they are to be distributed, based on community property laws or state inheritance rules. In either case, these decisions may or may not coincide with your wishes.

Also, probate can be an expensive and time-consuming process that exposes the details of your estate to public scrutiny. The probate process can take months or even years, depending on the size and complexity of your estate. And the fees charged by attorneys and executors can diminish the amount of money your heirs ultimately receive.

> *If you die without a will, a judge's decisions during the probate process may or may not coincide with what you would have wanted.*

STEPS FOR DRAFTING A WILL

Drafting a last will and testament is one of the best ways to avoid these consequences. And the good news is that creating a will doesn't have to be difficult or expensive.

First, decide whether you'll hire an attorney or create a will on your own. While online programs and software can guide you through the process, nuances can complicate a seemingly basic situation.

Hiring a professional with the expertise appropriate to your needs is vital, particularly if your estate is relatively large and complex.

Next, you'll identify your heirs and beneficiaries and name an executor for your estate. This person will be responsible for ensuring that your intentions communicated in the will are carried out. Many people choose their spouse or a close friend to serve as executor. But the duties of an executor can be complex and time-consuming, so be sure the person you designate can fulfill the executor's duties.

If you have minor or dependent children, you'll need to name a guardian who'll raise them until the age of majority. Give this decision careful consideration and make sure the person or couple you choose is willing to accept the responsibility.

The final step is to assess and divide your property. List all your assets and assign a percentage of your total assets to each of your beneficiaries. Or make individual bequests of specific assets or property to heirs. Keep in mind, also, that certain assets, such as IRAs and life insurance, are designed to be

transferred without regard to your will. The named beneficiary will inherit the property even if your will says otherwise. Review your beneficiary designations to make sure they reflect your wishes.

DON'T PROCRASTINATE

If you're among the more than half of Americans who don't have a last will and testament, make plans now to draft one soon. Your loved ones will be very glad you did. •

IRS provides guidance on pass-through deduction

The new Section 199A "pass-through" deduction provides valuable tax benefits for owners of sole proprietorships, S corporations, partnerships and limited liability companies taxed as partnerships. But the original tax code section left many questions unanswered. Taxpayers, however, may rely on new IRS guidance on the pass-through deduction until the agency issues final regulations.

A QUICK RECAP

Under Sec. 199A, eligible taxpayers may deduct up to 20% of their qualified business income (QBI) from a pass-through entity. QBI is an owner's share of the net of qualified items of income, gain, deduction and loss (excluding capital gains, dividends and nonbusiness interest income) from a qualified trade or business. It doesn't include reasonable compensation received by S corporation shareholders or guaranteed payments received by partners. Eligible taxpayers also may deduct up to 20% of their combined real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

The amount of the deduction is the *lesser* of 1) 20% of the taxpayer's QBI plus 20% of his or her qualified REIT dividends and qualified PTP income, or 2) 20% of the taxpayer's taxable income minus net capital gains.

For high-income taxpayers, there are two additional limitations:

1. The deduction for QBI (but not for REIT dividends and PTP income) is limited to a taxpayer's share of the entity's W-2 wages. Or, alternatively, this deduction is limited to 25% of W-2 wages plus 2.5% of the unadjusted basis of certain depreciable property.

2. The deduction is unavailable for specified service trades or businesses (SSTBs). That includes those in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, investing, investment management and trading (but not architecture or engineering). It also includes a "catchall" provision that encompasses "any trade or business where the principal asset . . . is the reputation or skill of one or more of its employees."

These limitations don't apply unless an owner's taxable income exceeds $157,500 ($315,000 for joint filers). Then they are phased in gradually, under a complex formula, and reach full force when taxable income rises to $207,500 ($415,000 for joint filers).

HIGHLIGHTS OF THE PROPOSAL

The proposed regulations are nearly 200 pages long, so a complete discussion is beyond the scope of this article. Here are some of the key provisions:

SSTBs. When Sec. 199A was first enacted, many feared that its catchall provision would ensnare a wide range of service businesses. Fortunately, the proposal interprets this category narrowly to apply only to people who receive income for endorsing products or services; for licensing their images, likenesses, names, voices, and so on; or for making appearances on television, radio, social media, and such.

The proposed regulations also exclude traditional banking services from the list of SSTBs and establish a de minimis rule: A business won't be deemed an SSTB if less than 10% of its gross receipts are attributable to one of the service areas listed above (5% for businesses whose gross receipts exceed $25 million). An antiabuse rule prevents SSTBs from qualifying for the deduction by spinning off their non-SSTB activities into a separate entity.

Aggregation of commonly controlled businesses. Under the proposal, taxpayers may elect to aggregate certain commonly controlled entities for purposes of Sec. 199A. For example, the rental or licensing of tangible or intangible property to a related trade or business may be treated as a single trade or business. That's if the two entities are commonly controlled (50% or more common ownership). Certain other requirements also must be met. Aggregation allows taxpayers to maximize their deductions, for example by combining the entities' W-2 wages and depreciable property investments.

W-2 wages defined. The proposed regulations clarify that W-2 wages include amounts paid by other entities. Among them, for example, are professional employer organizations or employee leasing firms. The IRS also issued a proposed revenue procedure outlining three alternative methods for calculating a business's W-2 wages.

Converting to independent contractor status. Some commentators have discussed the idea of converting employees to independent contractor status, enabling them to claim the pass-through deduction as sole proprietors. The proposed regulations clarify that, under those circumstances, one who continues to perform substantially the same services is presumed to be an employee rather than an independent contractor.

The proposal contains numerous other provisions addressing the computation of QBI, netting and carryover rules, pass-through entity reporting obligations and other issues.

STAY TUNED

Keep an eye on regulatory developments in the coming months. Once the proposed regulations are finalized, consult with your tax advisor about their impact on your eligibility for the pass-through deduction. And plan your tax strategies accordingly. •

Your business's real estate: Avoiding a costly mistake

Your business consists of a variety of physical assets, but the largest physical asset is often the building and the land it sits on. Many businesses choose to separate ownership of the building and real estate from the business itself.

Why? The strategy shields these assets from claims by creditors if your company ever files for bankruptcy (assuming the property isn't pledged as loan collateral). And the property is better protected against claims that may arise if a customer is injured on your property and sues your business.

WHAT ABOUT THE TAX ANGLE?

There are also tax considerations. For C corporations, the costs of owning real estate are generally treated as ordinary expenses on the company's income statement. But when the real estate is sold, any profit is subject to double taxation: first at the corporate level and then at the owner's individual level when a distribution is made. As a result, putting real estate in a C corporation can be a costly mistake.

If the real estate were held instead by the business owner(s) or in a pass-through entity, such as a limited liability company (LLC) or limited partnership, and then leased to the corporation, the profit upon a sale of the property would be taxed only once — at the individual level.

WHAT'S A WISE TAX STRATEGY?

The most straightforward and seemingly least expensive way for a business owner to maximize the tax benefits is to buy the property outright. But this could transfer liabilities related to the property directly to the owner, putting other assets — including the business — at risk. This would negate part of the rationale for organizing the business as a corporation in the first place.

So, it's generally best to hold real estate in its own limited liability entity. The LLC is most often the vehicle of choice for this, but limited partnerships can accomplish the same ends if there are multiple owners. No matter which structure is used, though, make sure all entities are adequately insured.

WHAT ABOUT FAMILY BUSINESSES?

Family businesses face many distinctive challenges. One is that several family members may participate in the ownership of the company. Under such circumstances, separating real estate ownership from the business creates more options to meet the needs of multiple owners.

Let's say that a family business is passing from one generation to the next. One child is very interested in owning and operating the business but doesn't have the means to finance the purchase of both the business and its real estate.

If the two are separated, it's possible for one sibling to take over the business while other siblings hold the real estate. In this case, everyone can benefit: The child who buys the business doesn't have to share control with the other siblings, yet they can still reap benefits as property owners.

A TIME-TESTED MOVE

Businesses that own the building they're in, plus the land it's on, may have unnecessary tax and liability exposures. So, it may be smart to consider the time-tested strategy of separating the legal title of your business from the building and the land it's on. Talk with your tax advisor about your situation. •

After tax reform, does it pay to itemize?

Each year, when you file your individual federal income tax return, you have a choice: Take the standard deduction or itemize your deductions. Presumably, you'll end up choosing whichever way results in the least tax.

BIG CHANGES TO ITEMIZED DEDUCTIONS

That choice, however, is now more complicated under the Tax Cuts and Jobs Act (TCJA). By nearly doubling the standard deduction (see the "Standard deduction" chart on page 7) and limiting itemized deductions, the act reduces or eliminates the benefits of itemizing for many people.

As you work with your CPA or accountant to prepare your 2018 tax return, he or she will review your deductible expenses carefully to determine whether you're better off itemizing or taking the standard deduction. You also can discuss strategies for going forward to maximize your deductions.

The TCJA makes several significant changes to itemized deductions. For example, for tax years 2018 through 2026, the act suspends the deduction for interest on home equity debt in certain circumstances, and expands it in others.

For 2018, home equity debt used for anything other than "acquisition indebtedness" isn't deductible at all. The $100,000 cap applicable in prior years has been eliminated and, effectively, replaced with a limit of as much as $750,000. Determining whether the loan qualifies for the interest deduction depends on the specifics of the situation.

The TCJA also:

- Caps deductions for state and local taxes (SALT) at $10,000 per year,
- Limits deductions for home mortgage interest to interest on up to $750,000 of acquisition debt (down from $1 million), for debt incurred after Dec. 15, 2017 (but there's a lot of interplay between this and the allowable home equity debt discussed above),

- Suspends the category of miscellaneous itemized deductions that exceed 2% of adjusted gross income (AGI) — such as unreimbursed employee expenses, investment expenses and tax preparation fees,

Standard deduction

Filing status	2017 standard deduction	2018 standard deduction
Single	$6,350	$12,000
Married filing jointly	$12,700	$24,000
Married filing separately	$6,350	$12,000
Head of household	$9,350	$18,000
Qualifying widow(er)	$12,700	$24,000

- Permits deductions for unreimbursed medical expenses to the extent they exceed 7.5% of AGI (increasing to 10% in 2019),
- Allows deductions for personal casualty losses only to the extent they're attributable to a "federally declared disaster," and
- Increases the limit on cash contributions to public charities and certain private foundations from 50% to 60% of AGI.

The act also suspends the "Pease limitation," which reduced otherwise allowable itemized deductions for certain high-income taxpayers. But it's uncertain if the suspension will provide a tax benefit.

TURBOCHARGING YOUR DEDUCTIONS

There may be tax-planning strategies you can use to boost what you can deduct, such as "bunching" your charitable gifts. Say you're a joint filer with $8,000 in deductible mortgage interest and $15,000 in state income and property taxes. You also have $5,000 in deductible charitable gifts and no other deductible expenses.

With the $10,000 limit on SALT deductions, your itemized deductions total $23,000, so you're better off taking the $24,000 standard deduction. You can increase your deductions by donating $10,000 to charity every *other* year. This strategy allows you to take $28,000 in itemized deductions in donation years and the standard deduction in the off years.

Another potential strategy is to transfer real estate and other assets into one or more nongrantor trusts. If structured properly, each trust gets its own $10,000 SALT limit, which can be offset against its taxable income. But keep an eye on regulatory developments: The IRS doesn't like workarounds that avoid the $10,000 limit, so it may issue regulations designed to thwart these strategies.

TRACK YOUR EXPENSES

Under the TCJA, fewer people will benefit by itemizing deductions. However, the only way to know whether it pays to itemize is to track your deductible expenses during the year — and compare that amount to the standard deduction. •

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