ClientLine®

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A TAXING SITUATION

Starting your first business as a self-employed individual may be exciting, but it can also be taxing. To make the best of it, you'll need to understand and attend to your tax obligations.

SELF-EMPLOYMENT TAXES

While your previous employers paid half of the Social Security and Medicare taxes credited to you, you are now responsible for paying both halves. That's 12.4% for Social Security (up to $128,400 in taxable income for 2018 and $132,900 for 2019) and 2.9% for Medicare taxes. There are different formulas for figuring the tax depending on your legal structure, so consult your tax professional.

QUARTERLY TAX PAYMENTS

If you are self-employed, you'll have to pay quarterly taxes on your income. These payments include both your estimated income tax and projected Social Security and Medicare taxes. In 2019, quarterly payments are due on the 15th of April, June and September, or the first business day after, with the final quarterly payment for 2019 taxes due on January 15, 2020.

Needless to say, you have to stay on top of necessary paperwork, from copies of all tax returns to exact records of your income and expenses.

BUSINESS BENEFITS

There are benefits, too, of business ownership. The cost of doing business, whether from your home office or a rented space, is deductible. Depending on your business structure, you might also deduct premiums paid for you and your family for health and dental insurance.

One tax-advantaged benefit that may work for you now and later is a Simplified Employee Pension (SEP), which allows you to put away large amounts of money for your retirement. You can contribute to a SEP and deduct contributions from 2018 gross income up to your 2018 tax filing deadline, plus extensions. Talk to your tax professional to learn about this and other tax issues you might face.

Home Sweet Home

You could be eligible to deduct some costs of your home for business — if you follow strict rules. If you use part of your home or a detached structure like a garage "regularly and exclusively" for business purposes and it is your principal place of business, you can use one of two methods to take deductions.

Deduction Methods

Use the simplified option where you multiply $5 times up to 300 square feet of area in which you exclusively conduct business (up to $1,500). Or use the regular method, which is based on the percentage of your home devoted to business use.
If your rent, or pay mortgage interest utilities and other related costs were, for instance, $20,000 and your home office was 20% of your home, you could deduct $4,000 from taxable income.

Other rules and restrictions apply, so talk to your tax professional to learn more.

SELLING YOUR HOME

If you sell your home and don't buy another one, and you make a large profit on the sale, you could owe federal capital gains taxes on your profit.

BY THE NUMBERS

Typically, you can exclude up to $500,000 of the gain from your income if you file a joint tax return; up to $250,000 if you're single. You must pass the ownership and use test, which states you must have owned and lived in the home for two of the five years preceding the sale.

In some high-priced real estate areas, you can easily exceed these exclusions if you've owned a home for a while. If you kept good records, you should be able to deduct selling and purchasing costs, including commissions and fees, from taxable gains, even if the latter occurred years ago.

You can also use capital improvements made to your home, including a deck, a room addition or a garage, to subtract from your gross gain. This, according to the IRS, will result in an adjusted basis, which is typically your cost in acquiring your home plus the cost of capital improvements, less casualty loss amounts and other decreases.

THAT'S NOT ALL

Even if you're like most people and won't have to pay federal capital gains tax, there's a good chance you'll pay a variety of transfer taxes, which most states levy. These taxes range from negligible to invasive. Some areas have multiple taxes, with states, counties and even towns and cities taking their share. Generally, most will tax a small percentage of the sale price.

While these taxes may surprise you, take solace knowing that they will also increase the adjusted cost basis on the home you just sold. Talk to your tax professional for more information.

Client PROFILE

Marilyn owns a business with 20 employees. For the past five years, she has awarded cash gifts to her employees of the month, but she is concerned that the new tax law will adversely affect her and her rewarded employees. What should she do?

Rewarding employees in this way has obviously worked for Marilyn and her business and she may decide to continue this practice, but her business can't deduct the cost anymore. In the past, cash, gift cards and other non-tangible personal property used as employee achievement awards were deductible to the business and excluded from employees' taxable income.

Certain tangible gifts are still allowed but, according to the IRS, they don't include cash, cash equivalents, gift cards, gift coupons, certain gift certificates, tickets to theater or sporting events, vacations, meals, lodging, stocks, bonds, securities and similar items.

Other tangible gifts are both tax-deductible to the business and excluded from employees' taxable income if awarded for length of service or safety achievements. They might include a plaque, watch or similar item up to the exclusion of $400 (and $1,600 for qualified plan awards).

Client Profile is based on a hypothetical situation. The solutions discussed here may or may not be appropriate for you.

TURBO-CHARGE RETIREMENT SAVINGS

If you aren't saving enough for the future, the simplest way to increase your retirement plan balance is to increase contributions by 1%. If you're considering deferring 3% of a $50,000 salary, you would contribute $1,500 annually. Over 20 years at 6% compounded daily, your 3% contribution, which is $125 monthly, would have grown from zero to $57,994.74.

THE 1% DIFFERENCE

Now increase your savings from 3% to 4% of $50,000, about $167 per month. A $42 dollar monthly increase will grow your balance to $77,481 — an almost $20,000 increase. Add another 1% or increase your timeframe and you'll see similarly significant results.

For example, 4% over 30 years using the same criteria would grow your account to $168,628.

Try it yourself by clicking on the compound interest calculator at *www.investor.gov* or, better yet, talk to a financial professional to learn more.

CHOOSING THE RIGHT RETIREMENT PLAN

If you own a business, you'll need to explore the variety of employer-provided retirement plans before choosing one. Some allow participants to make contributions that are deductible from taxable income, timely during this tax season. Here's a summary of some of them:

SIMPLIFIED EMPLOYEE PENSION (SEP)

Ideal for solo entrepreneurs and very small companies, a SEP-IRA features large contribution limits and flexible rules. Employers can contribute to a SEP and credit deductions against their 2018 taxable income up to the filing deadline, plus extensions.

401(K) AND MORE

Employers with 401(k), 403(b) and most 457 plans will see contribution limits increase. Growing companies looking for a tax-advantaged way to provide a retirement plan for their employees might consider these plans, but only for 2019 and beyond. You can't make past-year contributions to these plans.

REALLY SIMPLE

SIMPLE IRAs are potentially less complicated to understand and less costly to set up. Employers make either matching (up to 3% of compensation) or nonelective contributions (2%), with employee salary deferral limits lower than most plans. Any employee who earned at least $5,000 during any two calendar years and is reasonably expected to earn $5,000 in the current calendar year must be eligible. Companies can fund the plan up to their tax filing deadlines, but employees can't make past-year contributions.

Q&A

Q I have a life insurance policy that names my son as beneficiary. Do I also need to include this policy in my will?

A It wouldn't hurt anything, but no you don't. That's because life insurance beneficiary designations take priority over terms of a will, even if they differ. In fact, the same holds true for the beneficiary designations of retirement plans and annuities. This is a good time to remind you that you should keep all your beneficiary and contingent beneficiary designations up to date. If you're interested in your beneficiaries getting the most from the benefit without triggering estate taxes or you want to avoid the public glare of probate, you might consider putting the life insurance policy in a trust.

Q My wife and I had investment losses in 2018 and would like to deduct them on my tax return. How much am I allowed to deduct for last year and going forward?

A You can deduct up to $3,000 (for joint filers, $1,500 for single filers) of net capital losses from your taxable income on your tax return. You may also carry over excess losses to the next tax year. Remember that long-term capital gains or losses are those on investments owned for more than one year.

ClientLine® SHORT BITS

> CONSUMER EXPECTATIONS MIXED. The Federal Reserve Bank of New York's Center for Microeconomic Data conducts a monthly survey of consumer expectations for the future. It found that in November 2018, for the eighth straight month, consumers expected an overall 3% inflation rate a year later. However, consumer expectations for home prices decreased 0.2% to 3.1%, and earnings' growth expectations fell for the second straight month to 2.0%, from 2.5% in October.

> PRODUCTIVITY RISES. The Bureau of Labor Statistics reports that non-farm labor productivity rose 1.3% from the third quarter of 2017 through the same period in 2018. This reflects a combination of hours and real productivity growth. The increase includes a 2.3% increase in hours worked and a 3.7% increase in output.

> JOB MARKET TIGHTENS. In September of 2018 there were more job openings than unemployed people. There were 7 million job openings at the close of September 2018, while there were only about 6.1 million unemployed people. During the first eleven months of 2018 the number of unemployed persons per job opening ranged from 0.9 to 1.1. This is a dramatic drop from July 2009, when there were 6.6 unemployed persons per job opening.

> WE LIKE OURS. Healthcare is increasingly expensive and viewed by many Americans less positively on a national level. However, most people like their own healthcare and insurance coverage. These are the findings of a November 2018 Gallup Poll of 1,037 adult Americans. Eight of 10 survey respondents rated their healthcare quality as excellent or good, and 69% gave their coverage the same grades. Just 55% viewed healthcare in general positively, and only one in three thought positively about coverage nationally.