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JUNE 2018 NEWSLETTER

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FIRM NEWS

DeEtte Loeffler will be speaking at the upcoming *National Business Institute's* seminar titled **Trusts: The Ultimate Guide** on August 20 and 21, 2018, at Hampton Inn, Downtown San Diego. Topics she will cover include Grantor Trusts and Tax Deduction with Trusts. For more information go to nbi-sems.com.

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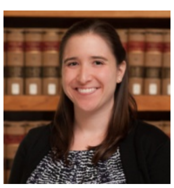


ADJUST YOUR TAX WITHHOLDING FOR 2018 TO AVOID PENALTIES

by Katie Lepore, CPA, J.D., LL.M., Taxation

Now that April 15 has passed, it is time to focus on the next tax year. Tax laws changed significantly for 2018, and many of the deductions which you just claimed on your 2017 income tax returns will not be available to you for 2018. The IRS strongly recommends taxpayers review their withholdings now. People living in high tax states, like California, are particularly vulnerable to the new taxes because the deduction for state and local taxes (including property taxes) is now limited to a total of $10,000. If you are a two-income family, and own a home in California, chances are you will have higher taxable income in 2018 because of this change.

<u>Personal Exemption and Standard Deduction</u>

Another big change is with regard to the personal exemption. Prior to 2018, taxpayers used to enjoy an automatic personal exemption for each member of the household plus either the standard deduction or itemized deductions. Now, there is no automatic personal exemption and instead taxpayers are required to choose between the greater of a higher standard deduction, or itemized deductions. The standard deduction for individuals in 2018 is $12,000 and for married couples filing jointly is $24,000. This is the amount to be taken for each filing type, regardless of whether you have dependents claimed on your return. Previously, taxpayers were permitted a personal exemption of $4,050 for each person claimed on the return (taxpayers and dependents, each), plus a standard deduction of $6,350 for single filers and $12,700 for married couples. For example, if on your 2017 joint return, you claimed four personal exemptions of $4,050 each (self, spouse, and two children), for a total of $28,900, in 2018 you would be limited to $24,000.

State Taxes Itemized Deduction

One of the possible itemized deductions is state taxes paid to California, or other states. In 2015, over 5 million California residents deducted over $80 billion in state tax payments to California on their federal returns.[1] The average state and local tax deduction for Californians who itemized in 2015 was over $18,400, according to the State Department of Finance.[2] Beginning in 2018, your deduction for all state taxes and property taxes paid will be limited to a maximum $10,000, regardless of whether you are a single filer or a married couple. Therefore, in comparing the option of a standard deduction of $12,000/$24,000 to your itemized deductions, many taxpayers who previously itemized their deductions will now be better served to take the standard deduction. This is particularly true for married couples who will have a harder time overcoming the additional $14,000 in deductions needed to itemize ($24,000 standard deduction less $10,000 in taxes paid) than single filers who only need an additional $2,000 to itemize ($12,000 standard deduction less $10,000 in taxes paid). This means that married couples need to have over $14,000 in any combination of other itemized deductions (such as mortgage interest or charitable deductions) to itemize their deductions. As a result, many taxpayers who donate to charity will not receive any tax benefit from their charitable donations.

Possible Penalties

While state tax payments were never deductible at the state level, both the IRS and California ask that taxpayers pay in the tax owed ratably over the year, as you earn your income. For most taxpayers, this is done through withholding by their employer. Those who may be self-employed or have large amounts of income from non-employee compensation, such as rental properties or retirement income, will want to perform a similar calculation to ensure they are paying adequate estimated taxes each quarter. If you do not pay in your tax ratably while you earn taxable income, you could face penalties when your return is due. The penalty on underpayment has been about 3-4% federally for the past several years. For California, there are harsher penalties and the FTB reports: "The penalty is 5 percent of the unpaid tax plus 1/2 of 1 percent for each month or part of a month that the tax remains unpaid not to exceed 40 months. The maximum penalty is 25 percent of the unpaid tax. The penalty is imposed regardless of an extension of time to file."[3]

Safe Harbors

There are certain "safe harbors" and ways to avoid tax penalties, though these may be temporary solutions for only one year if you are expecting your taxable income to increase for 2018 and every year thereafter. The first of these safe harbors to avoid underpayment penalties is if you owe $1,000 or less in taxes with your tax return. Second, you can avoid the penalties if you have paid in the lesser of a) 90% of the current year's tax due, or b) 100% of your prior year tax due. As long as you are withholding at least as much tax as you owed last year, you should be able to avoid any penalties on underpayment, though you may still have a large check to write come April 15. Two things to note: California requires 30% to be paid in by the first quarter, 40% paid in by the second quarter, and 30% at the fourth quarter, whereas the IRS requires an equal 25% every quarter. Secondly, if you are a high-income taxpayer (which is defined as having an Adjusted Gross Income of $150,000), the 100% of prior year tax due becomes 110%.

There is also an option available if you earned income unevenly throughout the year to "annualize" your income. For instance, if you sold a large amount of stock or sold a rental

[1] Bill Analysis from the Senate Governance and Finance Committee January 8, 2018. http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180SB227.

[2] Katy Murphy, "Will California Outmaneuver a New Federal Cap on Tax Deductions?" *Mercury News.* https://www.mercurynews.com/2018/01/02/will-california-outmaneuver-a-new-federal-cap-on-tax-deductions/.

[3] https://www.ftb.ca.gov/individuals/faq/ivr/401.shtml.

property at a late date in the year, you can show to the IRS that you were withholding ratably on income earned for all prior quarters, and in the quarter in which you incurred the additional tax due, you accurately withheld on it or made an estimated payment.

Financial Analysis

Certain taxpayers would rather owe tax at the end of the year if it allows them the ability to invest their earnings during the year to make additional money for themselves. For some, a 3-4% penalty on underpayment is worth the cost if they can earn 4+% by investing their money throughout the year. Any money paid into the IRS or FTB during the year will be removed from your disposable income, and if at the end of the year, you have overpaid, you will receive a refund without any interest included. Some others delight in receiving a refund from their taxes and dread cutting a large check in April, and therefore would rather avoid the possibility of penalties and have sufficient tax withheld during the year.

How to Calculate Your Withholding

The IRS has created a Withholding Calculator which is available on their website at IRS.gov. Please note that the calculator may not be accurate for taxpayers who have more than two jobs or who are self-employed and their income fluctuates throughout the year. You can use this tool to estimate your 2018 taxes due, and then file a new Form W-4 with your employer in the event you wish to change your withholding. You also could make additional estimated payments on your own if you choose not to have it withheld from your paycheck. You can speak with our office or your tax advisor if you wish to run some calculations as to what sort of tax liability you may have waiting for you next April. It is important to remember that an extension of time to file is not an extension of time to pay.

HEALTH LAW UPDATES FOR THE TERMINALLY ILL

By Katie Lepore, CPA, J.D., LL.M., Taxation

On May 30, 2018, President Trump signed into law the "Right to Try" Act, Senate Bill 204. The law gives terminally ill patients the right to use experimental medications which may not be fully approved by the FDA. Supporters of the bill say it will allow patients who are typically too ill to qualify for clinical trials access to possibly life-saving treatment. California already had a similar law enacted, which gives terminally ill patients the right to approach pharmaceutical companies and ask to use their drug outside of regulated clinical trials.[4]

Additionally, California approved legislation allowing for physician-assisted suicide in 2015. Earlier this month, however, a Riverside County judge overturned this legislation. The California Attorney General's Office plans to appeal the decision. The San Diego Tribune reports that: "In the first six months California's law was in effect, more than 100 people made use of it to end their lives. Fifty-nine percent of them had cancer, according to state data."[5]

If you have questions, or are interested in taking advantage of these new laws, please contact our office to discuss updates to your advanced health care directive and estate plan.

[4] https://www.cnn.com/2018/03/22/health/federal-right-to-try-explainer/index.html.

[5] https://www-sandiegouniontribune-com.cdn.ampproject.org/c/www.sandiegouniontribune.com/news/californiia/la-me-ln-end-of-life-option-act-20180515-story,amp.html.

FEDERAL TAX UPDATE

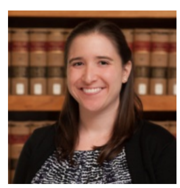
By DeEtte L. Loeffler, J.D., LL.M., Taxation and *Katie Lepore, J.D., LL.M., Taxation*

State Tax Workarounds. Our February 2018 newsletter detailed legislation that California lawmakers are considering which would allow California residents to make state income tax payments to a state charitable fund. The purpose of the law is to create a workaround for California residents to be able to deduct more than $10,000 in payments to the state as itemized deductions and instead claim such payments as charitable deductions, which are not subject to the $10,000 cap. The IRS recently issued Notice 2018-54 stating that it will issue Regulations soon addressing such state legislation (other states also implemented similar laws) and reminding taxpayers that federal law governs the proper characterization of payments. Based on this Notice, taxpayers can expect a higher risk of their returns being audited if they attempt to take such a state deduction.

Bill to Make Charitable Contributions Above the Line Deductions. Rep. Chris Smith (R-NJ) and Rep. Harry Cuellar (D-TX) introduced HR 5771, dubbed the “Charitable Giving Tax Deduction Act.” If passed, it would change charitable contributions from being itemized deductions to an above-the-line deduction. Such a change would allow all taxpayers to deduct charitable contributions prior to arriving at a computation of their adjusted gross income, thereby making all charitable donations tax-deductible rather than only providing a tax benefit to people who itemize their deductions. The bill is currently in the House Ways and Means Committee.

Health Savings Account Limit Raised. After the Tax Cuts and Jobs Act, the IRS announced that the amount a taxpayer could contribute to a Health Savings Account for family coverage was reduced to $6,850 due to inflation adjustments as outlined in the new laws for 2018. Earlier this month, the IRS announced the limit has been reinstated to its original $6,900 for 2018. The IRS also recently announced the limits for 2019 will be $3,500 for individuals and $7,000 for families.[6]

Decision Still Pending on Tax for Online Sales. In mid-April, the US Supreme Court heard arguments on the South Dakota case involving a state law that requires out-of-state companies without a physical presence in the state to collect state sales tax on Internet sales to state residents. Many states already impose a sales tax on e-commerce, but under a 1992 Supreme Court decision they cannot require out of state sellers to collect and remit the tax (i.e., taxpayers are required to do self-reporting). The Supreme Court appeared divided on whether to overturn its 1992 decision since Congress has failed to address this issue in the 26 years since the decision. Some large companies, like Amazon, already voluntarily collect and remit sales tax on some of their sales, but such cooperation is voluntary. A decision is expected by the end of June.



STATE TAX NEWS

by Katie Lepore, J.D., LL.M., Taxation and *DeEtte L. Loeffler, J.D., LL.M., Taxation*

Proposed Tax on Tap Water. Senate Bill 623, first introduced by Senator Bill Monning (D-Carmel) in 2017, has recently been encountering strong opposition. The bill would impose a tax on tap water usage, with funds to be used to clean up polluted groundwater in the State.[7] ABC News estimates that the tax could cost California taxpayers an extra $15/month on their water bills. The bill also imposes a “dairy fee” on milk producers and a “fertilizer fee” on all fertilizer materials. According to the Assembly Committee on Environmental Safety

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[6] https://www.journalofaccountancy.com/news/2018/may/hsa-contribution-limits-2019-201818933.html.

[7] https://www.10news.com/news/proposed-california-tax-on-tap-water-meets-opposition.

and Toxic Materials analysis of the bill, more than 300 systems in disadvantaged communities (200,000 people) have unsafe drinking water.[8] The bill has passed the Senate and currently is in Committee in the Assembly.

California Cities Considering a Head Tax. Some northern California cities are considering imposing a head tax on large employers to address local issues such as traffic congestion and homelessness. A head tax imposes a tax on employers based on the number of people they employ. In Seattle, where a $275 per employee head tax on employers with revenue in excess of $20 million[9] was recently adopted, Amazon and other large employers are already backing ballot measures to get the tax repealed, and threatening to move. Mountain View intends to vote on a similar tax proposal in June, while San Francisco is also considering a tax based on company revenues instead.[10] Palo Alto is taking another approach not focused on revenue, but on a per employee basis. This approach might increase its existing business tax from $104 for companies with over 100 employees to as much as $1.3 million for those with over 5,000 employees.[11]

Sales Tax on Services. On February 5, 2018, Senator Hertzberg (D-Van Nuys) introduced Senate Bill 993, which would levy a sales tax not only on sales purchases, but on services paid for by consumers. The Senate Governance and Finance Committee reports that the services excise tax would in turn reduce the sales tax paid for consumer goods, which is currently at 7.25%. The proposed tax would begin in 2020, with a 0.75% tax for the year 2020, 1.5% tax for the year 2021, and a 3% tax for all years thereafter. Such fees would be deposited in the General Fund. Companies with gross receipts under $100,000 a year would be exempted, as would certain other service providers, including medical and childcare providers.

Disclaimer: This newsletter is provided to share knowledge and expertise with our colleagues with the goal that all may benefit. The content of this newsletter is for general information purposes only.

The information contained within this newsletter is not intended to serve as legal advice or as a guarantee, warranty or prediction regarding the outcome of any particular legal or tax matter. Nothing contained within this newsletter should be used as a substitute for legal advice and does not create an attorney-client relationship between the reader and Miller, Monson, Peshel, Polacek and Hoshaw. Legal advice depends on the specific facts and circumstances of each individual's situation. You should not rely on this newsletter without first consulting with a qualified, licensed attorney.

[8] See link below: http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180SB623.

[9] https://www.geekwire.com/2018/controversial-seattle-head-tax-may-heading-south-silicon-valley-municipalities-weigh-new-tax-tech-giants/.

[10] https://www.seattletimes.com/business/technology/silicon-valley-cities-san-francisco-look-at-a-head-tax-like-seattle/.

[11] http://padailypost.com/2018/05/23/city-may-hit-big-tech-with-tax/.

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