CPA

Reagan & Company, PC
Certified Public Accountants since 1950

Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor℠

September 2017

Ginnie Mae Funds for Your Retirement

Many people prefer to have some conservative holdings in their IRAs and other retirement accounts. This century has already produced two nasty bear markets (in 2000–2002 and 2007–2009). If a third downturn occurs, investors will be glad they held some defensive positions, which might minimize losses and possibly offer gains.

When it comes to playing defense, Ginnie Maes may merit consideration. The nickname comes from the formal name, Government National Mortgage Association, or GNMA. This agency promises investors the payment of principal and interest from residential mortgage loans insured or guaranteed by federal entities, such as the Federal Housing Authority and the Department of Veterans Affairs. Ginnie Mae mortgage bonds are the only mortgage securities with full federal backing.

It's complicated

Ginnie Mae securities might be considered the "safe option" for retirement investing. Yields are not enormous in today's environment, but they may be relatively attractive. Typically, Ginnie Maes pay one to two percentage points of yield more than Treasuries. Why should supposedly safe Ginnie Maes pay more?

One answer rests with mortgage-backed securities. Most bonds lose value when interest rates rise but gain value when rates fall because their fixed yields become more attractive.

Mortgage-backed securities, including Ginnie Maes, also suffer losses when rates rise. However, rising rates can cause a slowdown in mortgage pre-payments because borrowers are less likely to refinance their loans. This slowdown means that Ginnie Mae investors have less money to reinvest at higher yields.

The opposite phenomenon affects mortgage securities when rates fall. More refinancing occurs as homeowners seek the lower loan rates. That means more cash flow to investors holding mortgage bonds and more money to reinvest at lower rates. Thus, mortgage-backed securities may lose more than conventional bonds when rates rise and gain less when rates fall.

Taxes, too

Treasury securities and funds holding them pay interest that's taxable at the federal level, but is generally exempt from state and local income taxes. Therefore, these

continued on page 2

What's Inside

Maximum Maintenance

The costs of homeownership are highest in the New York metro area with a 2.0% property tax rate, $78 average monthly home insurance, and $234 average monthly utility bill.

continued from page 1

holdings can be especially attractive to investors in high-tax areas.

Mortgage-backed securities, even federally backed Ginnie Maes, do not enjoy state or local tax exemption; they're fully taxable at all levels of government. This relative disadvantage, along with the complexity and interest rate threats, may explain the higher yields (versus Treasuries) that Ginnie Maes offer to investors. Their tax treatment also might cause Ginnie Maes to be an appealing holding in retirement accounts where all the income taxes can be deferred until money is withdrawn.

Favoring funds

Investors can often purchase individual Ginnie Mae bonds for around $25,000. Some retirees are pleased with these "pass-through" securities because they deliver monthly cash flow, reflecting the regular payments made on the underlying mortgages by homeowners. If you work with a savvy financial adviser or if you are willing to research Ginnie Maes on your own, this can be an astute choice.

That said, the Ginnie Mae market is complex, likely to lead to missteps by novice investors. Many people prefer owning shares of a fund and relying on the expertise of professionals to choose suitable Ginnie Maes. Diversification and a lengthy time frame might overcome interest rate concerns and deliver the benefits of relatively high yields. Many leading fund families, including Vanguard, Fidelity, and T. Rowe Price, have established Ginnie Mae mutual funds with performance records for investors to evaluate.

In terms of performance, Ginnie Mae funds generally had positive returns in 2008 when the stock market nosedived. The past is no guarantee of future results, but an encouraging track record might indicate that Ginnie Mae may be worth a place in a retirement portfolio. ■

Trusted Advice

Up With Housing

- The GNMA, or Ginnie Mae, helps make affordable housing a reality for millions of low- and moderate-income U.S. households.
- The Ginnie Mae guarantee allows mortgage lenders to obtain a better price for their mortgage loans in the secondary mortgage market, then use the proceeds to fund new mortgage loans.
- Ginnie Mae guarantees investors the timely payment of principal and interest on certain mortgage-backed securities.
- Besides loans insured by the Federal Housing Authority or guaranteed by the Department of Veterans Affairs, other guarantors or issuers of loans eligible as collateral for Ginnie Maes include the Department of Agriculture's Rural Development and the Department of Housing and Urban Development's Office of Public and Indian Housing.
- Ginnie Mae has never needed a bailout from the federal government. It does not buy or sell loans or issue mortgage-backed securities; its balance sheet doesn't use derivatives to hedge or carry long-term debt.
- Ginnie Mae securities are the only mortgage-backed security to carry the full faith and credit guarantee of the U. S. government.

Did You Know?

Employees spend a median of 2 hours a week dealing with personal financial matters while at work. Millennials (age 18–34) spend an average of 4 hours per week, those in Generation X (age 35–50) average 2 hours per week, and Baby Boomers (age 51–69) average 1 hour per week. Millennials' major concerns are retirement, savings habits, and paying down debt.

Source: Bank of America Merrill Lynch

Tax Credits Beat Tax Deductions

Many people prize tax deductions. The promise of a deduction can affect decisions in many areas, including charitable contributions, home buying, and investing in rental property.

However, tax deductions offer only partial relief because they reduce income, not the tax bill. The higher your income and tax bracket, the more you'll benefit from a tax deduction.

Example 1: Heidi Jones has recently finished her education and joined the work force. With a modest income, Heidi is in a 15% tax bracket. If Heidi donates $1,000 to charity (and if she itemizes deductions on her tax return), Heidi will reduce her taxable income by $1,000. In a 15% bracket, she will save $150 in tax (15% times $1,000).

Example 2: Ken Larsen, a middle-aged executive, has a high salary, placing him in the 33% tax bracket. If Ken itemizes a $1,000 charitable contribution, he'll save $330 (33% times $1,000), more than twice the amount of tax that Heidi saves for the same charitable gift.

Dollar for dollar

A tax credit, on the other hand, is a direct reduction of the tax you owe. If Heidi and Ken both receive a $1,000 tax credit, they'll both trim their tax obligation by $1,000. Moreover, many tax credits have income limits and phaseouts, which effectively means they're available to low- and middle-income taxpayers but not to people with relatively high incomes.

Here are some widely used tax credits.

Earned income tax credit

This credit is designed to help workers, including those with self-employment earnings, who have modest incomes.

The good news is that the earned income tax credit (EITC) is refundable.

Example 1: Jim Carter files his 2017 tax return. Without the EITC, Jim would owe $500 in tax. Jim's EITC amount is $1,200. Therefore, his $500 obligation is wiped out, and Jim would receive a check from the IRS for the $700 balance. (Most tax credits are not refundable, meaning that they do no more than offset any tax obligation.)

Besides having earned income, there are several other hurdles to clear to get the EITC. They include age (at least age 25, but under 65), investment income (no more than $3,450 in 2017), and filing status (married, filing separately, not eligible).

In addition, there are income limits for the EITC; those limits vary by filing status and by the number of qualifying children. (The definition of *qualifying children* is very broad for EITC purposes.) This year, for instance, a married couple filing a joint tax return with two *qualifying children* must have *both* earned income and adjusted gross income (AGI) of less than $50,597 to get this credit.

EITC amounts vary, as well. The 2017 maximum credit is $6,318 for a recipient with three or more qualifying children.

Child tax credit

For the child tax credit, the definition of a *child* is a bit more limited than it is for the EITC. Although the EITC can cover students under age 24, the child tax credit does not go beyond age 16. Other requirements apply.

The maximum tax credit is $1,000 for each qualifying child. This credit phases out after the taxpayer's income exceeds a threshold amount based on his or her income. The threshold amount depends on filing status—to get the maximum credit, for instance, a couple filing a joint return must have modified adjusted gross income (MAGI) of no more than $110,000. Above the threshold, the child tax credit drops by $50 per $1,000 of MAGI. Under a tax code provision known as the *additional child tax credit*, some of the credit may be refundable, depending on the amount of the taxpayer's earned income.

Child and dependent care tax credit

As the name indicates, this credit has two broad applications. One is for taxpayers who have children under age 13 and the other is for those who have spouses, dependents, or certain other individuals who are physically or mentally incapable of self-care. Either way, the credit is a portion of amounts paid to a caregiver so that the taxpayer can go to work, actively look for work, or go to school.

To calculate this credit, start by finding the amount spent on qualifying care for a given calendar year. Here, the maximum amount that counts is $3,000 for one qualifying person and $6,000 for two or more people needing care.

However, this maximum credit amount may be limited for some individuals. The maximum amount is limited, in the case of a single individual, to the individual's earned income for the year. In the case of a married individual, the maximum amount is limited to the

lesser of the individual's earned income or the earned income of the individual's spouse. In addition, if the individual receives dependent care benefits that he or she excludes from income, the maximum credit amount is reduced by the amount of the dependent care benefits excluded.

This resulting amount is multiplied by a percentage that depends on your AGI. The minimum percentage, used by many who claim this credit, is 20%, which applies when AGI is $43,000 or more.

Example 2: Paul and Robin Scott, who have $100,000 in AGI, pay over $6,000 to caregivers for their two children this year. Therefore, the Scotts multiply the maximum amount ($6,000) by the minimum percentage (20%) to get $1,200, the amount of this tax credit they can claim. (Claimants may also be responsible for payroll tax reporting in some situations.)

More credits, more assistance

Many other tax credits are available, including some for higher education. For all of them, the rules go beyond these brief descriptions. Our office can help you plan to make the most of these dollar-for-dollar tax savers. ■

R&D Tax Credits for Small Companies

Just as individuals get a dollar-for-dollar tax savings from tax credits, the same is true for businesses that qualify for tax credits. The Protecting Americans from Tax Hikes (PATH) Act of 2015, passed in 2016, expanded the ability of small companies to use the research and development (R&D) tax credit. The R&D credit is based not on the total amount a business spends on R&D, but on increases in R&D spending. Not only is a tax credit better than a tax

continued on page 4

continued from page 3

deduction, but R&D costs not covered by the credit may not be immediately deductible.

The spending that counts for the R&D credit might be for in-house wages and supplies, as well as for outside contracts that are considered qualified research expenditures. Money spent on activities such as developing new or improved products, processes, or formulas; developing prototypes or models; developing new technology; and developing or applying for patents may qualify.

To obtain the R&D credit, diligent recordkeeping is required. Defining which outlays qualify as R&D can be a challenge, so companies should be able to support their claims. Moreover, certain small businesses may run into additional obstacles, such as the alternative minimum tax (AMT) and a lack of taxable income that prevents using tax credits currently.

Addressing the AMT

Generally, a company that owes the AMT cannot use the R&D tax credit to reduce its AMT obligation. However, in some cases, the PATH Act allows the R&D credit to offset the AMT. Eligible companies are sole proprietorships, partnerships, or nonpublic corporations with average annual gross receipts under $50 million for the prior three tax years. In the case of pass-through entities, partners and S corporation shareholders may be able to use the R&D credit against their individual AMT liability.

Offsetting payroll taxes

The R&D tax credit is nonrefundable, so it generally doesn't help companies with no income tax liability. Another PATH provision addresses this problem for young companies that do substantial R&D yet have no tax liability to reduce. Eligible firms can use the credit to reduce payroll tax, rather than income tax.

To qualify, a corporation or partnership must have less than $5 million of gross receipts in the year of claiming the credit and no gross receipts in any year before the fourth preceding year. Thus, this tax break is mainly for startups. A company that qualifies can use up to $250,000 of R&D tax credits to reduce its employer share of Social Security payroll tax outlays, so cash can be retained. If current payroll tax doesn't equal the amount of the R&D credit a company can claim, carryforwards may be possible.

The complexity of the R&D tax credit and the required recordkeeping may discourage small companies from claiming it. If your company is devoting resources to developing new products and technology, our office can determine if seeking this credit will be worthwhile and help you provide the necessary documentation. ■

TAX CALENDAR

September 2017

September 15

Individuals. If you are not paying your 2017 income tax through withholding (or will not pay in enough tax during the year that way), pay the third installment of your 2017 estimated tax. Use Form 1040-ES.

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

Corporations. Deposit the third installment of estimated income tax for 2017. Use the worksheet Form 1120-W to help estimate tax for the year.

Partnerships. File a 2016 calendar-year return (Form 1065). This due date applies only if you timely requested an automatic six-month extension. Provide each partner with a copy of their final or amended Schedule K-1 (Form 1065) or substitute Schedule K-1 (Form 1065).

S corporations. File a 2016 calendar-year income tax return (Form 1120S) and pay any tax due. This due date applies only if you timely requested an automatic six-month extension. Provide each shareholder with a copy of Schedule K-1 (Form 1120S) or a substitute Schedule K-1.

OCTOBER 2017

October 16

Individuals. If you have an automatic six-month extension to file your income tax return for 2016, file Form 1040, 1040A, or 1040EZ and pay any tax, interest, or penalties due.

Corporations. File a 2016 calendar-year income tax return (Form 1120) and pay any tax, interest, and penalties due. This due date applies only if you timely requested an automatic six-month extension.

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

October 31

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the third quarter of 2017. 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 November 13 to file the return.

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

The *CPA Client Bulletin* (ISSN 1942-7271) is prepared by AICPA staff for the clients of its 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 *www.aicpastore.com*.

CPA Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

September 2017

Citation and Resource Guide

Sidney Kess, CPA, JD, Editor

Ginnie Mae Funds for Your Retirement

- The low risk aspect of Ginnie Mae's business model is illustrated at **www.ginniemae.gov/about_us/who_we_are/Pages/our_business_model.aspx.**

Tax Credits Beat Tax Deductions

- The AICPA's *Journal of Accountancy* has an article on how new rules affect popular tax credits at **www.journalofaccountancy.com/newsletters/2017/feb/new-rules-popular-tax-credits.html.**

R&D Tax Credits for Small Companies

- The IRS provides details on the tax credit for increasing research activities at **www.irs.gov/pub/irs-regs/research_credit_basic_sec41.pdf.**

Practice Development Tip

Look Hard at Leveraged IRA Withdrawals

Some financial advisers encourage clients to leverage withdrawals from traditional IRAs. As you prepare for year-end tax planning meetings with clients, this can be a topic of interest to many people.

The leveraging strategy falls into two categories. One is for clients who have reached age 70½ and must take required minimum distributions (RMDs) from their IRAs. If these people do not need the RMD for living expenses, they can pay the resulting income tax and use the net proceeds to pay for an insurance policy on their lives.

Alternatively, people younger than 70½ may be urged to take IRA distributions that are not required. These distributions may be calculated to keep the IRA owner within his or her current tax bracket. Again, the after-tax amount can be used to buy life insurance. (This arrangement may work best if the IRA owner has reached age 59½, beyond the 10% early withdrawal penalty.)

Either way, these plans revolve around taxes. Traditional IRA distributions generally will be taxed, with payments coming from the account owner or from a beneficiary. The greater the tax-deferred buildup, the more that eventually will be due to the IRS.

On the other hand, death benefits from a life insurance policy usually avoid income tax, and most beneficiaries won't have to deal with federal estate tax. So, IRA withdrawals now likely will be taxable, but by putting the after-tax money into life insurance, the IRA owner may be able to deliver a larger tax-free amount to loved ones in the future.

At year-end tax planning meetings, you can explain these ideas to clients. Go over their specific situations (age, health, need for IRA money in retirement, prospective beneficiaries) to discuss whether this approach may be helpful. If clients are interested, suggest they contact their life insurance agent for proposals. Offer to look over any policy illustration to see if the numbers appear to offer a tax-efficient method for dealing with IRA distributions.

Practice Development & Management Resources

from the AICPA

For more information or to order, log onto www.aicpastore.com or call 888.777.7077.

Planning for Retirement Needs, 13th edition

- Retirement planning covers both accumulating and preparing for retirement, as well as making decisions during retirement. This publication covers the basic concepts you need to know to discuss your client's retirement planning needs. **[Item no. PPF1507P—AICPA Member $149.00, Nonmember $169.00]**

CPA Client Bulletin

Smart Tax, Business & Planning Ideas *from your* Trusted Business Advisor[sm]

September 2017

Fundamentals of Income Taxation, 12th edition

■ This publication addresses specific areas in the tax process that are needed for financial planning. Learn about taxation of specific items like annuities, life insurance, and modified endowment contracts; specific tax deductions and credits, such as charitable deductions and education related credit; the nuances of passive activity losses and how to determine when they apply; and the impact of entity selection and the related tax considerations for owners, partners, and shareholders.
[Item no. PPF1508P—AICPA Member $149.00, Nonmember $169.00]

AICPA PCPS/CPA.com MAP Survey National Summary

■ AICPA's Private Companies Practice Section (PCPS) partnered with CPA.com on the National MAP (Management of an Accounting Practice) Survey, which was fielded from mid-May through July 2016. This summary provides financial and other key benchmarking data from the survey. This product will provide you with comparative benchmarking data relative to firm size and region that can help you create strategic goals and maximize your firm's performance.
[Item no. PCPSSUR03—AICPA Member $200.00, Nonmember $300.00]

Management of an Accounting Practice eHandbook

■ This is your go-to resource for all things practice management. Streamlined online guidance for easy reading and quick reference on the topics you care about: employee compensation and benefits, staffing, disaster recovery, firm organization, benchmarking, strategic planning, and more!
[Item no. MAP-XX—AICPA Member $149.00, Nonmember $189.00]

MAP On Track

■ Often, practitioners and small- to medium-sized firms find it challenging to stay on top of firm management responsibilities. The new Management of an Accounting Practice On Track (MAP On Track) will help keep you organized. This new scheduler is easy to download and functions as an add-in to Microsoft Outlook, adding tasks to keep your firm running throughout the year. As an added bonus, within the automatically scheduled tasks, you'll find useful links to relevant content within the comprehensive MAP eHandbook as well as PCPS tools that can inform your next steps.
[Item no. MAPTKD—AICPA Member $229.00, Nonmember $289.00]

CPA Client Bulletin Select

■ Do you ever wish you had more flexibility with your CPA Client Newsletter content? Now you can with this new monthly offering from the AICPA. Optimize your client and prospect communications with the AICPA's trusted CPA Client Newsletter content, now available in a flexible, editable MS Word format for use in your firm blog, social media outlets, traditional client newsletter communications, and beyond.
[Item no. PCN1301W—AICPA Member $549.00, Nonmember $689.00]

Need help with your subscription?

Contact our Member Service Center at 888.777.7077 or *service@aicpa.org.*

Questions or comments about the content?

Contact Whitney Woody, Managing Editor, at 919.402.4857 or *CBeditor@aicpa.org*.