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Client Bulletin

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

March 2017

Playing Defense as Stock Prices Soar

As of this writing, major U.S. stock market indexes are at or near record highs. This bullish run might continue...or it might end with a severe slide. Here are some strategies to consider.

Stay the course

Many investors will prefer to keep their current stock market positions. For nearly a century, every stock market reversal has been followed by a recovery. Even the severe shock of late 2008 through early 2009 has led to new peaks less than a decade later.

What's more, holding onto stocks and stock funds won't trigger any tax on capital gains.

Move into cash

Investors who are truly nervous about pricey stocks can sell some or all of those holdings, then put the sales proceeds into vehicles that historically have been safe havens, such as bank accounts and money market funds. This would reduce or eliminate the risk of steep losses from a market crash. In both the 2000–2002 and the 2007–2009 bear markets, the S&P 500 Index of large-company stocks fell about 50%. After a loss of that magnitude, investors need a 100% rebound, just to regain their portfolio value.

However, cash equivalents have negligible yields right now, so investors would essentially be treading water in bank accounts and money funds. Timing the market has proven to be extremely difficult, so investors who go to cash risk missing out on future gains as well as possible losses. In addition, investors who sell appreciated equities held in taxable accounts will owe capital gains tax, which could be substantial.

Move into bonds

Aside from cash, bonds have long been considered a lower risk counterweight to stocks. According to Morningstar's Ibbotson subsidiary, large-company U.S. stocks have suffered double-digit losses in five different calendar years since the 1970s. In 2008, that loss was 37%.

Long-term government bonds, on the other hand, have had fewer down years. The only year they lost more than 9% was 2009, when a drop of 15% was reported. That 2009 loss, though, came after a 26% gain in

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What's Inside

States for Seniors

Of more than 55 million total Medicare beneficiaries, about 10 million live in just two states: California and Florida.

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Trusted Advice

Treasury bond interest

- ❖ Interest income from Treasury bills, notes, and bonds is subject to federal income tax.
- ❖ That interest is exempt from state and local income taxes.
- ❖ If you invest in a bond fund that holds only U.S. Treasuries, you will owe federal income tax on the interest income but no state or local income tax on that interest.
- ❖ Although the bonds held in a bond fund pay interest, the fund will pay dividends to the fund's investors. Those dividend payments will be taxed at the federal level as interest income, at ordinary income rates.

2008, when stocks tanked. Therefore, Treasury bonds can be a useful hedge against stock market losses.

Yields on the 10-year Treasury are currently around 2.6%, so long-term Treasury bond funds may pay about 2%: not great, but more than the payout from cash equivalents. Intermediate-term Treasury funds will have lower yields but also less exposure to stock market volatility.

Investors in high tax states may have another reason to favor Treasury bonds and Treasury funds because the interest from these investments is exempt from state and local income tax. To benefit from the tax break, you must hold Treasuries in a taxable account.

Treasuries certainly can be held in a tax-deferred account such as a 401(k) or an IRA, and many investors do so. However, the state and local income tax break might be lost because withdrawals from tax-favored retirement plans may be fully taxable. (Some states offer tax exemption to distributions from retirement plans, often up to certain amounts.)

Individual circumstances

All of these strategies have advantages and drawbacks, so you should proceed with caution. Very generally, buy and hold strategies might appeal to workers who are some years from retirement. A market drop may turn out to be a buying opportunity, especially for those who are investing periodically through contributions to 401(k) and similar plans. On the other hand, trimming stocks might be prudent for people in or near retirement. Investment opportunities at low stock prices may be reduced, and a market skid can be particularly dangerous for retirees who are tapping their portfolio for spending money. ■

Holding Down Premiums for Medicare Part B

Medicare, the federal government's health insurance program for people 65 and older, has four parts (see Trusted Advice, "ABCDs of Medicare"). Although Medicare offers good value to many seniors, high-income Medicare enrollees can pay over $5,000 a year for Part B, whereas high-income couples on Medicare can pay over $10,000 in annual premiums. For that money, high-income enrollees get the same Medicare coverage that most seniors get for about $1,300 a year, or $2,600 for couples.

Income-based premiums

Medicare Part B, which covers doctor visits and some other medical outlays, charges a monthly premium. Most enrollees have that premium deducted from their Social Security deposits, paying around $109 a month in that manner. (The "standard" amount, paid by some enrollees, is $134 a month in 2017, about $1,600 a year.) However, in 2017, seniors with certain levels of income will pay more, with premiums increasing as income tops certain thresholds.

reported on your tax return, plus any tax-exempt interest income. What's more, there is a two-year lag between reported income and the resulting Part B premium.

Income			Monthly payment in 2017
File individual tax return	***File joint tax return***	***File married & separate tax return***	
above $85,000 up to $107,000	above $170,000 up to $214,000	Not applicable	$187.50
above $107,000 up to $160,000	above $214,000 up to $320,000	Not applicable	$267.90
above $160,000 up to $214,000	above $320,000 up to $428,000	above $85,000 and up to $129,000	$348.30
above $214,000	above $428,000	above $129,000	$428.60

Source: medicare.gov

For this purpose, "income" refers to modified adjusted gross income (MAGI), which equals the AGI

Example 1: Carl and Donna Egan reported $210,000 of AGI on their 2015 tax return, which they filed in April 2016. The Egans also had $20,000 of tax-exempt interest in 2015. (The amount of tax-exempt interest is reported on federal income tax returns, even though that interest is not subject to federal income tax.) Thus, the Egans' MAGI, for determining their Medicare Part B premium in 2017 is $230,000. With that MAGI, Carl and Donna will each have $267.90 a month deducted from their Social Security benefit, for a total of $535.80 a month, or $6,430 a year.

What's more, the MAGI thresholds for these extra Part B premiums ($85,000, $107,000, etc.) are fixed until 2019, so they won't increase for inflation, at least for a few years. At the same time, the extra Part B premium amounts can be increased, and have been rising rapidly. With identical MAGI in 2014, the Egans would each have paid $243.60 a month for Part B in 2016, so this year's premium of $267.90 a month represents a 10% increase. The maximum Part B premium rose from $389.80 a month in 2016 to $428.60 a month in 2017. Even higher Part B premiums are likely in the future, as medical costs continue to rise.

Cliff notes

The Part B premiums are set by MAGI "cliffs": Go over by $1, and you fall into a higher premium. The Egans, in our example, had 2015 MAGI of $230,000, $16,000 over the relevant threshold, yet, they are paying the same premiums as another couple with 2015 MAGI of $314,000—which was $100,000 over the same threshold of $214,000.

This system can be frustrating for Medicare enrollees who are just over a Part B MAGI threshold. The good news, though, is that some advance planning may enable seniors who are just over a Part B threshold to bring MAGI below that threshold, with relatively modest tax planning.

Example 2: Say the Egans once again would have $230,000 of MAGI for 2016, as reported on the tax return they are about to file for last year. If either Carl or Donna is eligible to make, say, a tax-deductible contribution to a SEP-IRA for 2016 or to recharacterize a Roth IRA conversion from 2016, it could be possible to fine tune the transaction, bringing MAGI for 2016 down to $213,000. They'd be under the $214,000 MAGI threshold and owe less for Part B in 2018.

Going forward, the Egans might spend time during 2017 on various tax-planning tactics. That could decrease the Part B premium they'll owe in 2019, and ongoing tax planning could hold down future premiums. Possible strategies might include the timing of capital gains and Roth IRA conversions, for example.

Tax planning shouldn't be driven solely by efforts to reduce Part B premiums. However, this issue should be included in overall tax planning by high-income Medicare enrollees and by people who soon will be in that situation. Reining in Part B premiums may become increasingly important in the coming years, due to expected financial strains on Medicare and federal efforts to raise more money from high-income taxpayers.

Trusted Advice

The ABCDs of Medicare

- Part A covers hospital stays, some nursing care, hospice care, and some home care.
- Part B covers doctors' services and some medical supplies.
- Part C, known as Medicare Advantage, includes plans from private companies that contract with Medicare to provide Part A and Part B benefits.
- Part D adds prescription drug coverage from private companies. High-income seniors also pay more for Part D, so steps taken to reduce Part B premiums also might cut the cost of Part D.

Paring Part B premiums

The examples of Carl and Donna Egan assume that they continue to have high incomes, even after they're covered by Medicare. Conversely, some Medicare enrollees will report high income in 2017, then find themselves hard pressed to pay the resulting Part B premiums in 2019, due to changed circumstances.

Taxpayers whose income has fallen can appeal their elevated Part B premium to the Social Security Administration. Acceptable reasons for relief include retirement, in full or in part. Our office can let you know if an appeal on this issue is likely to succeed, and how to proceed. ■

Safe Harbor 401(k) Plans for Small Companies

Among employer-sponsored retirement plans, 401(k)s have become the standard. Some prospective employees assume that a job will come with a 401(k). Therefore, offering a 401(k) at your company may help you hire desired workers, and help you retain valued employees.

That said, there can be drawbacks to sponsoring a traditional 401(k). Such plans require annual testing to ensure that a 401(k) does not discriminate in favor of highly compensated employees, including owner-employees. Failing such a test may limit the amount that

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company principals and certain others may contribute to the plan, resulting in a reduced tax-deferred retirement fund for key individuals.

One solution is to offer a safe harbor 401(k) for your small business. A study released in late 2016 by Employee Fiduciary, a 401(k) provider for small businesses, found that 68% of the small firms responding to the survey use a safe harbor 401(k) plan design to avoid annual nondiscrimination testing. A safe harbor 401(k) allows sponsoring companies to avoid these tests, providing the business makes certain contributions to employees' accounts. The mandatory employer contributions are always 100% vested.

Employer options

Employers have several ways to reach this safe harbor. Many companies prefer the "basic match" approach. Here, the company matches 100% of employee contributions to the 401(k), up to 3% of compensation, plus a 50% match on contributions up to 5% of pay. Thus, the maximum match is 4% of an employee's compensation. (Some companies use an "enhanced match," which might be 100% on the first 4% of pay.)

Alternatively, employers can shelter in a safe harbor with a "nonelective contribution." Here, the company contributes 3% of compensation to each eligible employee's 401(k) account, regardless of whether a worker is making elective deferrals.

Either way, the safe harbor contributions can be limited to employees earning less than $120,000 in 2017.

Considering the costs

Safe-harbor 401(k)s might not be a good fit for every small business. The required employer contributions may wind up being extremely expensive. Other efforts, such as employee education that increases contributions from non-highly compensated workers, may be a more cost-effective approach. Also, safe harbor 401(k)s have certain notice requirements. If you are interested in a safe harbor 401(k) for your company, our office can explain the notice requirements and provide an estimate of the cost involved, to help you make an informed decision. ■

TAX CALENDAR

MARCH 2017

March 15

Partnerships. File a 2016 calendar-year return (Form 1065). Provide each partner with a copy of Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return and provide Schedule K-1 or a substitute Schedule K-1, file Form 7004. Then file Form 1065 by September 15.

S corporations. File a 2016 calendar-year income tax return (Form 1120S) and pay any tax due. Provide each shareholder with a copy of Schedule K-1 (Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc., or a substitute Schedule K-1. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

S corporation election. File Form 2553, Election by a Small Business Corporation, to choose to be treated as an S corporation, beginning with calendar year 2017. If Form 2553 is filed late, S corporation treatment will begin with calendar year 2018.

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

APRIL 2017

April 18

Individuals. File a 2016 income tax return. If you want an automatic six-month extension of time to file the return, file Form 4868, Application for Automatic Extension of Time To File U.S. Individual Income Tax Return. Then, file Form 1040, 1040A, or 1040EZ by October 16.

If you are not paying your 2016 income tax through withholding (or will not pay in enough tax during the year that way), pay the first 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 March if the monthly rule applies.

Household employers. If you paid cash wages of $2,000 or more in 2016 to a household employee, file Schedule H (Form 1040) with your income tax return and report any household employment taxes. Report any federal unemployment (FUTA) tax on Schedule H if you paid total cash wages of $1,000 or more in any calendar quarter of 2015 or 2016 to household employees. Also report any income tax you withheld for your household employees.

Corporations. File a 2016 calendar-year income tax return (Form 1120) and pay any tax due. If you want an automatic six-month extension of time to file the return, file Form 7004 and deposit what you estimate you owe.

Corporations. Deposit the first installment of estimated income tax for 2017.

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Citation and Resource Guide

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Playing Defense as Stock Prices Soar

- Information about Treasury securities can be found at **www.treasurydirect.gov/indiv/products/products.htm.**

Holding Down Premiums for Medicare Part B

- The Social Security Administration's publication, *Medicare Premiums, Rules For Higher-Income Beneficiaries*, is available at **www.ssa.gov/pubs/EN-05-10536.pdf.**

Safe Harbor 401(k) Plans for Small Companies

- The IRS spells out the rules on safe harbor 401(k)s at **www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview.**

Practice Development Tip

Spread the Word on the New IRA Rollover Rules

Client meetings during tax preparation season can be an excellent time for you to present information while you're receiving tax return data. This year, clients may be interested in hearing about new IRS rules on IRA rollovers, released in 2016.

Generally, people who take money from an IRA or 401(k) or another tax-deferred retirement account must put the same amount back into a retirement plan within 60 days. If the deadline is missed, the amount not replaced will be considered a taxable distribution, and a 10% penalty also may apply before age 59½.

The IRS may extend the 60-day deadline, under some circumstances. However, such an extension previously required requesting a private letter ruling (PLR) from the IRS, at a cost of a $10,000 filing fee, plus any professional charges. As a result, many people who missed the 60-day deadline, even for a good reason, accepted the consequences rather than pay for a PLR, which might not be accepted.

Revenue Procedure 2016-47 signaled a major departure from the IRS. Now, taxpayers who missed the 60-day deadline can "self-certify" that a hardship caused their lateness. Money can go back into a tax-deferred account, without tax consequences.

This Revenue Procedure listed 11 specific hardships that can be self-certified. For instance, error by the financial institution handling an IRA is considered an acceptable hardship. A taxpayer's self-certification can be challenged by the IRS and, if proven to be invalid, taxes and penalties can be assessed.

In your client meetings this tax season—and later—you can briefly explain the new rules. Tell your clients that you'll help with the self-certification process, if it becomes necessary. Even if clients never need help in this situation, informing them about the new rules can help to solidify your position as a knowledgeable adviser about retirement plans.

Practice Development and Management Resources

from the AICPA

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Managing Your Tax Season

- Reduce stress and make the most of your staff's time and skills with this hands-on guide to improving your tax season. Filled with checklists, sample letters, and worksheets to help keep your clients happy while effectively managing workflow during the busiest time of your year.

  [Item nos. PTX1402P—AICPA Member $79.00, Nonmember $99.00 and PTX1402E—AICPA Member $69.00, Nonmember $85.00]

Leading an Accounting Firm: The Pyramid of Success

■ Build a stronger firm with this guide to CPA firm leadership. *Leading an Accounting Firm* teaches you how to improve your personal leadership and build great leaders around you by guiding you through the essential ideas and practices that are at the core of great leadership and great firms.

[Item no. PPM1201P—AICPA Member $59.00, Nonmember $69.00]

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]

The Engaged Employee: 10 Initiatives for Successful Firms

■ The most successful firms have discovered a solution that retains the best and the brightest while driving desired business outcomes: employee engagement. In this book, author Sandra Wiley presents 10 key initiatives that your firm can employ to foster engagement.

[Item nos. PPM1402P—AICPA Member $49.00, Nonmember $59.00 and PPM1402E—AICPA Member $45.00, Nonmember $55.00]

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