



# Client Bulletin

Smart Tax, Business & Planning Ideas from your Trusted Business Advisor<sup>SM</sup>

## The Third Best Investment You Can Make

June 2017



The second-best investment you can make is paying off high interest rate debt (see *CPA Client Bulletin, August 2016*). That could come after you've contributed enough to your 401(k) to get a full match from your employer. What should come next? If you have no expensive debt to pay down and you're getting the full employer match, where should you direct your money? Here are some suggestions.

### Unmatched 401(k) contributions

In 2017, employees can contribute up to \$18,000, or \$24,000 if they're at least age 50. Few (if any) company matches are that generous.

**Example 1:** Julie Benson earns \$100,000 a year. Her employer's 401(k) match is dollar-for-dollar, up to 6% of pay, so Julie will put at least \$6,000 into

the plan this year to get \$6,000 in "free money" from the match. Julie, age 45, could contribute another \$12,000.

Such a contribution is easy to do, with the money flowing directly into the 401(k) with every paycheck. The deferred income won't be subject to income tax and any investment earnings can compound, untaxed. Other possible advantages include access to plan loans, offered by many companies, and considerable shelter from creditors.

That said, the main benefit of an unmatched 401(k) contribution is income tax deferral. If you are in a relatively high tax bracket now and expect to be in a lower bracket when you take withdrawals in retirement, maximizing 401(k) contributions could pay off. On the other hand, tax deferral might not appeal to workers in their 20s with modest incomes, perhaps deferring tax in a 15% bracket, who will face uncertain tax rates on distributions decades from now.

### Roth IRA contributions

A Roth IRA is always funded with after-tax dollars, so there is no upfront tax benefit. However, distributions from a Roth IRA, made after the 5-year period beginning with the first tax year of a contribution to a Roth IRA and after the

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## Going Higher

*Nearly 40% of people under 65 with employer-based insurance had high-deductible health plans in 2016, up from over 25% in 2010.*

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## Trusted Advice

### Roth IRA Distributions

- Roth IRA owners do not include distributions that are a return of regular contributions in their gross income.
- “Qualified distributions” from a Roth IRA also are not included in gross income.
- A qualified distribution is any payment from a Roth IRA made after the 5-year period beginning with the first taxable year of a contribution to a Roth IRA, and
  - made after the date the Roth IRA owner reaches age 59½;
  - made because of the Roth IRA owner’s disability;
  - made to the Roth IRA owner’s beneficiary or estate after death; or
  - that qualifies as a “first-time homebuyers’ distribution” (up to a \$10,000 lifetime limit).

Roth IRA owner reaches age 59½, are completely tax-free. Therefore, putting some money into a Roth IRA can provide a source of tax-free cash in retirement instead of, or in addition to, taxable withdrawals of money from a 401(k). Roth IRA contributions can

be up to \$5,500 in 2017, or \$6,500 for those 50 or older.

**Example 2:** Assume that Julie Benson, with her \$100,000 salary, desires to save \$15,000 for retirement this year. Julie might put \$6,000 into her 401(k) to get the match and put \$5,500 into a Roth IRA. That would total \$11,500, so Julie could achieve her \$15,000 savings goal by contributing another \$3,500 to her 401(k) without a match.

Roth IRA owners never have required distributions, which generally impact pretax retirement funds after age 70½. It’s true that income limits may crimp Roth IRA contributions—single taxpayers can’t contribute for 2017 with modified adjusted gross income of at least \$133,000, or \$196,000 on joint tax returns.

However, there are no income limits for making nondeductible contributions to a traditional IRA and then converting that amount to a Roth IRA. This workaround won’t generate income tax for people who have no pretax money in traditional IRAs.

Roth IRAs may be especially appealing to people in relatively low tax brackets now, who will get only modest tax savings from unmatched 401(k) contributions.

### Health savings accounts

Another possibility exists for people with certain high deductible health

insurance coverage. Besides paying for the insurance, such people can have a health savings account (HSA) that offers unique tax advantages.

HSAs have no income limits. Contributions, which are tax deductible, can go up to \$3,400 for 2017 and up to \$6,750 for those with family coverage. (People 55 or older can contribute \$1,000 more.) Inside an HSA, earnings are tax-free and distributions are untaxed if the HSA owner spends at least that much on qualified health care costs.

**Example 3:** Suppose that Julie Benson is eligible for an HSA. With single coverage, Julie contributes \$3,400 this year, which she invests in stock funds. Although past performance is no guarantee of future success, stocks historically have done well over long time periods. Therefore, Julie hopes that annual contributions to her HSA will provide her with a substantial fund to tap for medical bills in retirement.

Besides contributing \$6,000 to her 401(k) to get the full match, and \$3,400 to her HSA, Julie can still contribute \$5,500 to a Roth IRA for a total of \$14,900 in 2017. Each of these options has features that go beyond those mentioned in this article, but they all may be viable choices for retirement investing. Our office can explain their tax impact on your particular situation. ■

## Prenups Can Serve Many Purposes

Some people may think of prenuptial agreements as asset protection vehicles for wealthy individuals who are about to be married. When a wealthy individual gets engaged, a “prenup” can help safeguard the assets that individual brings into the marriage

from passing to the future spouse in the case of a subsequent death or divorce.

Beyond such situations, prenups may be adopted by other about-to-be-weds. That’s especially true now that second (or even third) marriages are

increasingly common, with children from prior unions to be considered.

**Example:** Jim Smith and Ann Jones have set their wedding date. Neither is considered wealthy, but they both own debt-free homes and have retirement plans, investment accounts, and other

assets. In addition, Jim and Ann already have their own children from previous marriages.

In such situations, a well-crafted prenup can delineate specific assets that will go to those children after a possible divorce or the death of one spouse. Terms of the agreement will vary from one situation to the next, but one approach is to set aside certain assets brought into the marriage for each spouse's children.

In addition to such an asset division, a prenup can address whether the couple will file a joint income tax return and who will pay the tax. Also, debts incurred before and after the marriage should be covered in the agreement.

### Other uses

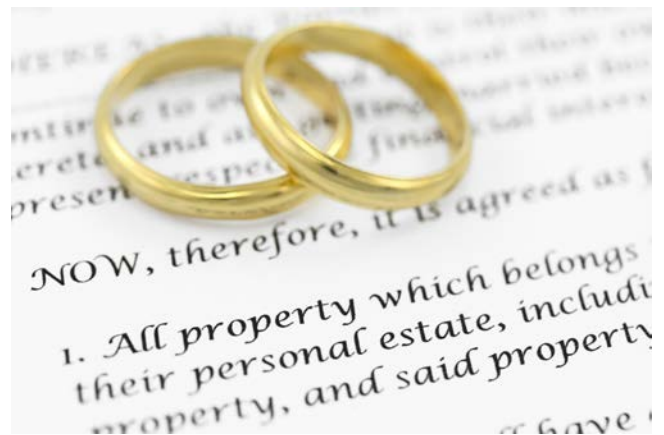
Even if children from a prior marriage are not an issue, prenups can be helpful. For example, for two people who enter a first marriage after they've both had careers and built up significant assets, a prenup can preserve those assets if the marriage doesn't work. A business owner might want to provide for the retention of the company and a valuation method in case of a divorce; partners or co-shareholders may insist on prenups to keep a portion of their business from ex-spouses in the future. Wealthy parents might want

to be sure that a son or daughter executes a prenup before the wedding ceremony.

However, saying that a prenup can do this or that is only a beginning. To be effective, a prenuptial agreement must be enforceable under the laws of the relevant state. Very generally, a prenup should be

- **formal.** Ideally, the agreement should be drafted by an attorney with experience in this area.
- **voluntary.** Compliance shouldn't be coerced. Suppose the parents of the bride are paying for the wedding and the groom's family produces a prenup once the out-of-town guests have arrived, asserting that the bride would get nothing in case of a divorce. Such a document may not stand up to a challenge in court.

One tactic that can help to produce a valid prenup is to discuss the issue as early as possible. A prenup that's been agreed upon after both sides have had competent counsel is more likely to be upheld. For



- some marriages, the wealthier individual will hire the attorney to draft the agreement and the other party's attorney will review it to suggest any changes.
- **fair.** Full disclosure of assets may be required of both prospective spouses. If one party can show the other failed to reveal substantial assets, the aggrieved spouse may be entitled to more than the agreed-upon amounts.

### Retaining romance

Of course, someone who is about to "live happily ever after" may not feel comfortable suggesting a prenup to a bride- or groom-to-be. One strategy to deflect the blame is to say that your CPA or your attorney is insisting on a prenup.

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## Solo 401(k) Plans for Companies Without Employees

Among major corporations, 401(k) plans have become common, but even the smallest of businesses can have a 401(k) plan for retirement. One-participant 401(k) plans, known by names such as Solo 401(k) and Uni-k, are available. For some business owners and self-employed individuals, Solo 401(k)s may offer a chance to save more for retirement with tax

advantages compared with other small business retirement plans.

The name is somewhat misleading, as these plans are not necessarily limited to one person. A business owner's spouse also can participate, if he or she is an employee of the business. Multiple owners or partners, and their spouses employed in the business, can participate in a Solo 401(k).

However, a business with any common-law employees is disqualified, so having an employee other than an owner, business partner, or shareholder will rule out a Solo 401(k). Note that independent contractors can be hired by the business, as well as part-time workers who get paid for less than 1,000 hours a year. Solo 401(k) plans are discretionary, so employers can cut

back or even eliminate contributions in a given year, if that's desirable.

## Potent payoff

Assuming a business qualifies for a Solo 401(k), why choose this type of plan? The answer is simple: because contributions can be relatively generous. The underlying reason is that owner-employees' accounts receive funding from two sources.

Example 1: Nick Martin, age 55, owns 100% of NM Corp., which has elected to be treated as an S corporation. NM Corp. has no full-time employees. With a Solo 401(k), Nick can contribute the same as any employee participating in a typical 401(k) plan: up to 100% of compensation ("earned income," for the self-employed). The cap in 2017 is \$18,000, or \$24,000 if Nick is at least age 50.

In addition, Nick can make employer non-elective contributions up to 25% of his compensation, as defined by the plan. Assume that Nick earns \$80,000 in W-2 wages from NM Corp. in 2017. He defers the

maximum \$18,000 in regular elective contributions this year, plus the \$6,000 catch-up for those 50 and older. NM Corp. then contributes \$20,000 (25% of Nick's \$80,000 earnings) to the plan, for a total of \$44,000. If Nick's wife works for NM Corp. and receives earned income, her account can receive 401(k) contributions.

Those with higher earned income can receive larger employer contributions. In 2017, the maximum is \$54,000 from employee and employer contributions, or \$60,000 with a \$6,000 catch-up contribution.

## Special rules for the self-employed

The calculation for Solo 401(k) contributions is a bit different for self-employed participants. Here, earned income is defined as net earnings from self-employment after deducting employee elective contributions and one-half of self-employment tax. The calculation can be complex, but the resulting employer contribution might be up to 20% of self-employment income. Self-employed individuals

who file Schedule C typically deduct both the employer and employee contributions to a Solo 401(k) on page 1 of Form 1040, not on Schedule C. Therefore, these deductions reduce adjusted gross income but not reported business income. Incorporated businesses generally can deduct Solo 401(k) contributions as a business expense.

For all types of participants, Solo 401(k) plans offer another appealing feature. There is no need to perform expensive nondiscrimination testing for the plan, because there are no employees who might have received disparate benefits. Such testing may be required with standard 401(k) plans and can result in reduced contributions to business owners' accounts. Even though nondiscrimination testing isn't required, a Solo 401(k) plan generally must file an annual report on Form 5500-SF if it has \$250,000 or more in assets at the end of the year.

The deadline for establishing a Solo 401(k) for 2017 is December 31, or the end of the fiscal year for corporations. ■

# TAX CALENDAR

## JUNE 2017

### June 15

**Individuals.** If you are not paying your 2017 income tax through withholding (or will not pay enough tax during the year that way), pay the second installment of your 2017 estimated tax.

If you are a U.S. citizen or resident alien living and working (or on military duty) outside the United States and Puerto Rico, file Form 1040 and pay any tax, interest, and penalties due for 2016. If you want additional time to file your return, file Form 4868 to obtain four additional months to file. Then, file Form 1040 by October 16.

**Corporations.** Deposit the second installment of estimated tax for 2017.

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

## JULY 2017

### July 17

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

### July 31

**Employers.** For Social Security, Medicare, and withheld income tax, file Form 941 for the second 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 August 10 to file the return.

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

If you maintain an employee benefit plan with a calendar year-end, file Form 5500 or 5500-EZ for calendar year 2016.



## Citation and Resource Guide

Sidney Kess, CPA, JD, Editor

### The Third Best Investment You Can Make

- The IRS explains the tax rules on Roth IRA distributions in Publication 590-B, "Distributions From Individual Arrangements (IRAs)," p. 30, at [www.irs.gov/pub/irs-pdf/p590b.pdf](http://www.irs.gov/pub/irs-pdf/p590b.pdf).

### Prenups Can Serve Many Purposes

- The Association of the Bar of the City of New York provides information about prenuptial agreements at [www.nycbar.org/get-legal-help/article/family-law/marital-agreements/prenuptial-agreements/](http://www.nycbar.org/get-legal-help/article/family-law/marital-agreements/prenuptial-agreements/).

### Solo 401(k) Plans for Companies Without Employees

- The IRS explains the rules for one-participant 401(k) plans at [www.irs.gov/retirement-plans/one-participant-401k-plans](http://www.irs.gov/retirement-plans/one-participant-401k-plans).

## Practice Development Tip

### Don't Postpone Mid-Year Tax Planning

President Trump has promised to propose major tax legislation, but no action has been taken as of this writing. If that's still the case in June, when this issue of the *CPA Client Bulletin* appears, you may be tempted to wait for word from Washington before scheduling mid-year tax planning meetings with key clients.

That's one way to handle the current uncertainty, but there's no knowing when tax legislation will emerge this year. Meanwhile, putting off mid-year tax planning sessions can deprive you of a chance to meet with clients and bolster your position as a valued adviser.

With that in mind, you may want to schedule mid-year tax planning in June or July, as you usually do. Chances are, there will be many tax-saving tactics to discuss with clients, regardless of proposed legislation.

For example, this can be a good time to reconsider annual salary deferrals to 401(k) and similar plans. Are clients able to contribute more than they had anticipated?

Considering the market volatility we have seen, clients may have paper losses on some investments. Selling devalued securities can yield valuable capital losses, perhaps permitting tax-free gains in the future. At this point in the year, clients will have ample time to weigh reinvestment options.

Income shifting plans might be put in place to save tax. The kiddie tax provision affects parents with children under age 24 who are full-time students, among others. In 2017, parents owe tax on a child's unearned income in excess of \$2,100. Up to that amount, though, a "kiddie's" investment income may be lightly taxed. In the right situation, clients may be able to benefit from children's low tax obligations.

The kiddie tax doesn't apply to older students or to clients' parents who are retired with modest incomes. Some savvy tax planning may help clients' family members take advantage of the 0% tax rate that now applies for certain long-term capital gains and qualified dividends.

If a taxpayer is in a tax bracket lower than 25%, the recipient of a net long-term capital gain or a qualified dividend would not be subject to tax. In 2017, the 25% tax bracket begins at taxable income of \$37,950 for single filers, at \$75,900 for those filing jointly, and at \$50,800 for heads of household. Therefore, if a high-income taxpayer shifts property having capital gains or qualified dividend income to eligible relatives who have taxable income below these amounts, the resulting tax would be zero.

Undoubtedly, the list of tax-saving opportunities can go on. If you've regularly held mid-year tax planning meetings, you may have many other items to go over. Such meetings can help clients hold down their tax obligation for the year and can help reinforce your expertise in this area.

Moreover, you can assure clients that you will keep them informed if and when any substantial tax legislation is passed this year. Of course, we will cover such legislation as soon as possible in the *CPA Client Bulletin*.



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[Item no. PPM1307HI—AICPA Member \$119.00, Nonmember \$149.00]

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[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.

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