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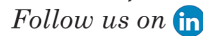
Follow us on 

Tax & Business Alert

FEBRUARY 2019

MULTISTATE RESIDENT? WATCH OUT FOR DOUBLE TAXATION

Contrary to popular belief, there's nothing in the U.S. Constitution or federal law that prohibits multiple states from collecting tax on the same income. Although many states provide tax credits to prevent double taxation, those credits are sometimes unavailable. If you maintain residences in more than one state, here are some points to keep in mind.

DOMICILE VS. RESIDENCE

Generally, if you're "domiciled" in a state, you're subject to that state's income tax on your *worldwide* income. Your domicile isn't necessarily where you spend most of your time. Rather, it's the location of your "true, fixed, permanent home" or the place "to which you intend to return whenever absent." Your domicile doesn't change — even if you spend little or no time there — until you establish domicile elsewhere.

Residence, on the other hand, *is* based on the amount of time you spend in a state. You're a resident if you have a "permanent place of abode" in a state and spend a minimum amount of time there — for example, at least 183 days per year. Many states impose their income taxes on residents' worldwide income even if they're domiciled in another state.

POTENTIAL SOLUTION

Suppose you live in State A and work in State B. Given the length of your commute, you keep an apartment in State B near your office and return to your home in State A only on weekends. State A taxes you as a domiciliary, while State B taxes you as a resident. Neither state offers a credit for taxes paid to another state, so your income is taxed twice.

One possible solution to such double taxation is to avoid maintaining a permanent place of abode in State B. However, State B may still have the power to tax your income from the job in State B because it's derived from a *source* within the state. Yet State B wouldn't be able to tax your income from other sources, such as investments you made in State A.

HOW TO ESTABLISH DOMICILE

Under the law of each state, tax credits are available only with respect to income taxes that are "properly due" to another state. But, when two states each claim you as a domiciliary, neither believes that taxes are properly due to the other. To avoid double taxation in this situation, you'll need to demonstrate your intent to abandon your domicile in one state and establish it in the other.

There are various ways to do so. For example, you might obtain a driver's license and register your car in the new state. You could also open bank accounts in the new state and use your new address for important financially related documents (such as insurance policies, tax returns, passports and wills). Other effective measures may include registering to vote in the new jurisdiction, subscribing to local newspapers and seeing local health care providers. Bear in mind, of course, that laws regarding domicile vary from state to state.

MINIMIZE UNNECESSARY TAXES

This example illustrates just one way double taxation can arise when you divide your time between two or more states. Our firm can research applicable state law and identify ways to minimize exposure to unnecessary taxes. ■

YOU'VE GOT TIME: SMALL BUSINESSES CAN STILL SET UP A 2018 SEP PLAN

Are you a high-income small-business owner who doesn't currently have a tax-advantaged retirement plan set up for yourself? A Simplified Employee Pension (SEP) plan may be just what you need, and now may be a great time to establish one.

A SEP plan has high contribution limits and is simple to set up. Best of all, there's still time to establish one for 2018 and make contributions to it that you can deduct on your 2018 income tax return.

2019 DEADLINES FOR 2018

A SEP plan can be set up as late as the due date (including extensions) of your income tax return for the tax year for which the plan is to first apply. That means you can establish a plan for 2018 in 2019 if you do it before your 2018 return filing deadline. You have until the same deadline to make 2018 contributions and still claim a potentially hefty deduction on your 2018 return.

Generally, other types of retirement plans would have to have been established by December 31, 2018, for 2018 contributions to be made (though many of these plans do allow 2018 contributions to be made in 2019).

HIGH CONTRIBUTION LIMITS

Contributions to SEP plans are discretionary. You can decide how much to contribute each year. But be aware that, if your business has employees other than you, 1) contributions must be made for all eligible employees using the same percentage of compensation as for you, and 2) employee accounts are immediately 100% vested. The contributions go into SEP-IRAs established for each eligible employee.

For 2018, the maximum contribution that can be made to a SEP-IRA is 25% of compensation (or 20% of self-employed income net of the self-employment tax deduction) of up to $275,000, subject to a contribution cap of $55,000. (The 2019 limits are $280,000 and $56,000, respectively.)

SIMPLE TO SET UP

A SEP plan is established by completing and signing the very simple Form 5305-SEP ("Simplified Employee Pension — Individual Retirement Accounts Contribution Agreement"). Form 5305-SEP isn't filed with the IRS, but it should be maintained as part of

the business's permanent tax records. A copy of the form must be given to each employee covered by the plan, along with a disclosure statement.

Because of their simplicity and the great flexibility you have in making contributions, SEP plans are good "starter" retirement plans for small businesses. They're also well suited for cash-flow dependent businesses such as construction companies, restaurants and seasonal businesses that may not always have dollars at the ready to contribute.

LESS ONEROUS

Additional rules and limits do apply to these plans, but they're generally much less onerous than those for other retirement plans. Contact our firm to learn more about SEP plans and how they might reduce your tax bill for 2018 and beyond. ■

FEWER TAXPAYERS TO QUALIFY FOR HOME OFFICE DEDUCTION

Working from home has become commonplace for people in many jobs. But just because you have a home office space doesn't mean you can deduct expenses associated with it. Beginning with the 2018 tax year, fewer taxpayers will qualify for the home office deduction. Here's why.

CHANGES UNDER THE TCJA

For employees, home office expenses used to be a miscellaneous itemized deduction. Way back in 2017, this meant one could enjoy a tax benefit only if these expenses plus other miscellaneous itemized expenses (such as unreimbursed work-related travel, certain professional fees and investment expenses) exceeded 2% of adjusted gross income.

Starting in 2018 and continuing through 2025, however, employees can't deduct *any* home office expenses. Why? The Tax Cuts and Jobs Act (TCJA) suspends miscellaneous itemized deductions subject to the 2% floor for this period.

Note: If you're self-employed, you can still deduct eligible home office expenses against your self-employment income during the 2018 through 2025 period.

OTHER ELIGIBILITY REQUIREMENTS

If you're self-employed, generally your home office must be your principal place of business, though there are exceptions.

Whether you're an employee or self-employed, the space must be used regularly (not just occasionally) and exclusively for business purposes. If, for example, your home office is also a guest bedroom or your children do their homework there, you can't deduct the expenses associated with that space.

DEDUCTION OPTIONS

If eligible, you have two options for claiming the home office deduction. First, you can deduct a portion of your mortgage interest, property taxes, insurance, utilities and certain other expenses, as well as the depreciation allocable to the office space. This requires calculating, allocating and substantiating actual expenses.

A second approach is to take the "safe harbor" deduction. Here, only one simple calculation is necessary: $5 multiplied by the number of square feet of the office space. The safe harbor deduction is capped at $1,500 per year, based on a maximum of 300 square feet.

MORE RULES AND LIMITS

Be aware that we've covered only a few of the rules and limits here. If you think you may qualify for the home office deduction on your 2018 return or would like to know if there's anything additional you need to do to become eligible, contact us. ■

THROWING SNOWBALLS AT YOUR MOUNTAIN OF DEBT

Many people start the year intending to get out of debt, yet end the year owing just as much, if not more. One approach that might yield success is called "throwing snowballs."

Under this method, you organize your debts from the lowest balance to the highest balance and begin paying off the debt on top of the list. The idea is to throw as many "snowballs" as you can gather or earn at that first creditor until the debt is gone.

While you hurl these snowballs, pay the minimum amount to your other creditors. Avoid trying to send an extra $20 or so a month to each one. If you want to contribute extra money, throw it at your primary target.

Once the first debt is paid off, you should have even more money to send to the next one. Over time you can start heaving bigger and bigger snowballs at the remaining targets because, as you pay off each debt, you'll have more money to pay toward remaining debts.

The objective is to start an avalanche of payoffs until your debts disappear. Under this method, the best predictor of success isn't the number of dollars you pay off but rather the number of accounts that you close.

Please note: There's some debate on the practicality of throwing snowballs. Opponents argue that you should first pay off debts with the highest interest rates. We can help you choose a debt-reduction strategy that's right for you. ■

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