THE VOS VOICE

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"Because Accounting Matters And We Know It"

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Inside This Issue

A Review of Significant TCJA Provisions Impacting Individual Taxpayers

Now that 2019 has begun, there isn't too much you can do to reduce your 2018 income tax liability. But it's smart to begin preparing for filing your 2018 return. Because the Tax Cuts and Jobs Act (TCJA), which was signed into law at the end of 2017, likely will have a major impact on your 2018 taxes, it's a good time to review the most significant provisions impacting individual taxpayers.

Rates and exemptions

Generally, taxpayers will be subject to lower tax rates for 2018. But a couple of rates stay the same, and changes to some of the brackets for certain types of filers (individuals and heads of households) could cause them to be subject to higher rates. Some exemptions are eliminated, while others increase. Here are some of the specific changes:

- Drops of individual income tax rates ranging from 0 to 4 percentage points (depending on the bracket) to 10%, 12%, 22%, 24%, 32%, 35% and 37%
- Elimination of personal and dependent exemptions
- AMT exemption increase, to $109,400 for joint filers, $70,300 for singles and heads of households, and $54,700 for separate filers for 2018
- Approximate doubling of the gift and estate tax exemption, to $11.18 million for 2018

Credits and deductions

Generally, tax breaks are reduced for 2018. However, a few are enhanced. Here's a closer look:

- Doubling of the child tax credit to $2,000 and other modifications intended to help more taxpayers benefit from the credit
- Near doubling of the standard deduction, to $24,000 (married couples filing jointly), $18,000 (heads of households) and $12,000 (singles and married couples filing separately) for 2018
- Reduction of the adjusted gross income (AGI) threshold for the medical expense deduction to 7.5% for regular and AMT purposes
- New $10,000 limit on the deduction for state and local taxes (on a combined basis for property and income or sales taxes; $5,000 for separate filers)
- Reduction of the mortgage debt limit for the home mortgage interest deduction to $750,000 ($375,000 for separate filers), with certain exceptions
- Elimination of the deduction for interest on home equity debt
- Elimination of the personal casualty and theft loss deduction (with an exception for federally declared disasters)
- Elimination of miscellaneous itemized deductions subject to the 2% floor (such as certain investment expenses, professional fees and unreimbursed employee business expenses)
- Elimination of the AGI-based reduction of certain itemized deductions
- Elimination of the moving expense deduction (with an exception for members of the military in certain circumstances)
- Expansion of tax-free Section 529 plan distributions to include those used to pay qualifying elementary and secondary school expenses, up to $10,000 per student per tax year

How are you affected?

As you can see, the TCJA changes for individuals are dramatic. Many rules and limits apply, so contact us to find out exactly how you're affected. We can also tell you if any other provisions affect you, and help you begin preparing for your 2018 tax return filing and 2019 tax planning.

ESTATE PLANNING LITE: COLLEGE-AGED CHILDREN NEED A BASIC ESTATE PLAN

If your son or daughter currently is home from college on winter break, now is a good time to sit down and discuss a few estate planning documents he or she should have at this stage of life. Let's take a closer look at four such documents:

1. Health care power of attorney. With a health care power of attorney (sometimes referred to as a "health care proxy" or "durable medical power of attorney"), your child appoints someone — probably you or his or her other parent — to make health care decisions on his or her behalf should he or she be unable to do so. A health care power of attorney should provide guidance on how to make health care decisions. Although it's impossible to anticipate every potential scenario, the document can provide guiding principles.

2. HIPAA authorization. To accompany the health care power of attorney, Health Insurance Portability and Accountability Act (HIPAA) authorization gives health care providers the ability to share information about your child's medical condition with you. Absent a HIPAA authorization, making health care decisions could be more difficult.

3. Financial power of attorney. A financial power of attorney appoints someone to make financial decisions or execute transactions on your child's behalf under certain circumstances. For example, a power of attorney might authorize you to handle your child's financial affairs while he or she is out of the country studying abroad or, in the case of a "durable" power of attorney, incapacitated.

4. Will. Although your child is still in his or her upper teens or early twenties and probably doesn't have too many assets, he or she isn't too young to have a will drawn up. A will is a legal document that arranges for the distribution of property after a person dies. It names an executor or personal representative who'll be responsible for overseeing the estate as it goes through probate.

If you have questions about any of these documents, don't hesitate to give us a call. We can help provide peace of mind that your child's health and financial affairs will be properly handled should the unthinkable happen.

A FRESH LOOK AT PERCENTAGE OF COMPLETION ACCOUNTING

How do you report revenue and expenses from long-term contracts? Some companies that were required to use the percentage of completion method (PCM) under prior tax law may qualify for an exception that was expanded by the Tax Cuts and Jobs Act (TCJA). This could, in turn, have spillover effects on some companies' financial statements.

Applying the PCM

Certain businesses — such as homebuilders, real estate developers, engineering firms and creative agencies — routinely enter into contracts that last for more than one calendar year. In general, under accrual-basis accounting, long-term contracts can be reported using either 1) the completed contract method, which records revenues and expenses upon completion of the contract terms, or 2) the PCM, which ties revenue recognition to the incurrence of job costs.

The latter method is generally prescribed by U.S. Generally Accepted Accounting Principles (GAAP), as long as you can make estimates that are "sufficiently dependable." Under the PCM, the actual costs incurred are compared to expected total costs to estimate percentage complete. Alternatively, the percentage complete may be estimated using an annual completion factor. The application of the PCM is further complicated by job cost allocation policies, change orders and changes in estimates.

In addition to reporting income earlier under the PCM than under the completed contract method, the PCM can affect your balance sheet. If you underbill customers based on the percentage of costs incurred, you'll report an asset for costs in excess of billings. Conversely, if you overbill based on the costs incurred, you'll report a liability for billings in excess of costs.

Syncing financial statements and tax records

Starting in 2018, the TCJA modifies Section 451 of the Internal Revenue Code so that a business recognizes revenue for tax purposes no later than when it's recognized for financial reporting purposes. Under Sec. 451(b), taxpayers that use the accrual method of accounting will meet the "all events test" no later than the taxable year in which the item is taken into account as revenue in a taxpayer's "applicable financial statement."

Please see *A Fresh Look at Percentage of Completion Accounting* on page 3

A Fresh Look at Percentage of Completion Accounting **from page 2**

So, if your business uses the PCM for financial reporting purposes, you'll generally need to follow suit for tax purposes (and vice versa).

In general, for federal income tax purposes, taxable income from long-term contracts is determined under the PCM. However, there's an exception for smaller companies that enter into contracts to construct or improve real property.

Under the TCJA, for tax years beginning in 2017 and beyond, construction firms with average annual gross receipts of $25 million or less won't be required to use the PCM for contracts expected to be completed within two years. Before the TCJA, the gross receipts test limit for the small construction contract exception was $10 million.

Got contracts?
Compared to the completed contract method, the PCM is significantly more complicated. But it can provide more current insight into financial performance on long-term contracts, if your estimates are reliable. We can help determine the appropriate method for reporting revenue and expenses, based on the nature of your operations and your company's size.

"Because Accounting Matters"

TIME TO CELEBRATE! FASB EXPANDS VIE EXCEPTION FOR PRIVATE COMPANIES. The Financial Accounting Standards Board (FASB) recently gave private companies long-awaited relief from one of the most complicated aspects of financial reporting — consolidation of variable interest entities (VIEs). Here are the details.

Old rules
Accounting Standards Codification (ASC) Topic 810, Consolidation, was designed to prevent companies from hiding liabilities in off-balance sheet vehicles. It requires businesses to report on their balance sheets holdings they have in other entities when they have a controlling financial interest in those entities.

For years, the decision to consolidate was based largely on whether a business had majority voting rights in a related legal entity.

In 2003, in the wake of the Enron scandal, the FASB amended the standard to beef up the guidelines on when to consolidate.

New rules
The updated standard introduced the concept of VIEs. Under the VIE guidance, a business has a controlling financial interest when it has:

- The power to direct the activities that most significantly affect an entity's economic performance,
- The right to receive significant benefits from the entity, and
- The obligation to absorb losses from the entity.

Private companies contend that some of their most common business relationships could be considered VIEs under ASC 810. These relationships are set up for tax or estate planning purposes — not to trick investors or pump up stock prices.

Private company alternative
Private companies told the FASB that the VIE model forced them to consolidate multiple affiliated and subsidiary businesses onto a parent's balance sheet. This frustrated lenders and creditors, who wanted cleaner balance sheets. In addition, in companies where ownership is shared among close relatives, determining who holds the power may not always be clear.

In 2014, the FASB issued an updated standard that let private companies ignore the VIE guidance for certain leasing transactions. Private companies applauded this update, but problems persisted with the consolidation guidance for transactions that didn't involve leases.

So this past October, the FASB issued Accounting Standards Update (ASU) No. 2018-17, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities, which expands the exception to include all private company VIEs. However, a private company that makes use of the latest amendments to Topic 810 must disclose in its financial statements its involvement with, and exposure to, the legal entity under common control.

Right for you?
The amendments in ASU No. 2018-17 are effective for private companies for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted. Contact us to determine whether this election makes sense for your business — and, if so, when you should adopt the simplified alternative.

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DEADLINE TO MAKE AN ESTIMATED TAX PAYMENT ALMOST HERE: Will you owe federal income tax for 2018? It's not too late to make an estimated payment and avoid penalties. The 2018 fourth quarter tax payment deadline is Tuesday, 1/15/19. The IRS notes that "various financial transactions, especially those occurring late in the year, can often have an unexpected tax impact." For example, a holiday bonus, a real estate transaction or a capital gains distribution from an investment might trigger a higher tax bill. To make an estimated payment, use Form 1040-ES ("Estimated Tax for Individuals"). Contact us for help with this and other tax issues.

FOURTH QUARTER EMPLOYMENT TAX RETURN DUE: Attention employers! The 2018 fourth quarter employment tax return is due Thursday, 1/31/19. That is the Form 941 ("Employer's Quarterly Federal Tax Return"), which summarizes the total wages you paid during the quarter, and the total federal employment taxes due. If your tax bill is less than $2,500 you can pay it, in full, with a timely filed return using the accompanying voucher 941-V. If you have deposited your tax due on time, properly and in full, you have until 2/11/19 to file your Form 941. Contact us for help with this and other employment tax returns.

"In the middle of every difficulty lies opportunity."

-- Albert Einstein

FORM 8990 FOR REPORTING BUSINESS INTEREST: The IRS has released Form 8990 for reporting business interest, subject to the new Sec. 163(j) limit. Form 8990 is used to calculate the amount of business interest expense a taxpayer can deduct and the amount to carry forward to the next year. The form generally must be filed by a taxpayer with business interest expense, a disallowed business interest expense carryforward, or current-year or prior-year excess business interest expense. There are specific exclusions from filing Form 8990 - please contact us for more information.

"Great works are performed not by Strength but by Perseverance"

--Samuel Johnson

NEED HELP WITH YOUR FINANCIAL RECORDS? Need help with your financial records after a disaster? The IRS recently published a fact sheet that discusses the challenges encountered by taxpayers when putting together their financial records in the aftermath of a hurricane, wildfire or other catastrophe. The IRS notes that reconstructing these records soon after a disaster "may be essential for properly documenting a tax-deductible loss, supporting various tax-related transactions, or getting federal assistance or insurance reimbursement." – Contact us for further details.