Client Bulletin

Smart tax, business and planning ideas from your Trusted Business Advisor℠

October 2018

Supreme Court decision in *Wayfair* affects online sellers

If your company makes sales to out-of-state buyers, do you need to collect state sales tax? Until recently, Supreme Court decisions from the 20th century declared that would not necessarily be the case.

Example 1: ABC Corp., based in Alabama, sends a catalogue to customers and prospects. A consumer who lives in Wyoming places a $100 order.

Assume that ABC has neither employees nor property in Wyoming. ABC would not be required to collect Wyoming sales tax on the $100 purchase price and remit to Wyoming under those Supreme Court decisions because ABC had no "physical presence" in that state. (Wyoming, like most states, requires consumers to pay a use tax instead of a sales tax, but states have found it difficult to enforce compliance with their use taxes.)

Because they must collect sales tax, in-state retailers have been at a significant disadvantage versus out-of-state sellers who don't collect sales tax.

South Dakota v. Wayfair

The 20th century reasoning of the physical presence requirement did not recognize the realities of the 21st century, a divided (5-4) Supreme Court found earlier this year. In *South Dakota v. Wayfair, Inc.*, 6/21/18, the Court held that the physical presence requirement no longer applied, paving the way for enforcement of a South Dakota law that requires many "remote" sellers to collect applicable sales tax on purchases by South Dakota residents.

The majority in the *Wayfair* decision pointed to some favorable aspects of the South Dakota law. For one, it applies only to remote sellers with at least 200 transactions or $100,000 in revenue from South Dakota buyers in a calendar year. Therefore, a company that occasionally ships a few moderately priced items across state lines needn't master all the sales tax rules pertaining to South Dakota buyers and collect the tax and remit it to the state.

In addition, South Dakota is a party to the Streamlined Sales and Use Tax Agreement,

In this issue

Money from homes

U.S. household net worth topped $100 trillion for the first time in early 2018 as home values rose $500 billion, offsetting a decline in stock market values.

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which reportedly has 24 member states. This agreement, designed to standardize taxes in order to reduce administrative and compliance costs, provides sellers access to sales tax administration software.

Going forward

After this Supreme Court decision, many (perhaps most) states will consider new legislation that requires out-of-state vendors to collect and forward sales tax, even without a physical presence in the buyer's state. However, Congress might pass a federal law addressing the issue of interstate sales tax collection.

If no federal law is passed, the focus will remain on states' actions. Assuming that states follow the format of the South Dakota law, companies that do a minimum amount of online retailing may not be greatly affected.

Conversely, small businesses that do a great deal of selling online, or plan to do so, might have to make extensive efforts to collect and forward sales tax to multiple states. Our office can help such companies comply with any requirements that arise.

Buy-write strategies for a flat market

Up one month, down the next. The stock market this year has offered lots of excitement. As of this writing, broad market indexes have provided little sustenance for bulls or bears, with results not far from early 2018.

One strategy that may be appealing in a relatively flat stock market is to use covered calls. Even if the actual stock you own goes nowhere, trading in options may deliver meaningful investment income. The downside of this approach is that any gains in a strong upturn may be limited.

Selling the upside

A covered call strategy can begin with the purchase of a stock that seems appealing.

Example: In October, Carl Wagner buys 200 shares of XYZ Corp., trading at $50, for $10,000. He instructs his adviser to sell (or "write," in option lingo) two call options on XYZ stock at a $55 exercise price, expiring in January, which is three months away. Each call gives the option owner the right to buy 100 shares of XYZ for $55 apiece until a given date in January.

In this hypothetical example, Carl receives 90 cents per share from his sale of the call option. For his 200 shares, that's $180. From that point on, several things can happen.

Flat market

Say that XYZ shares bounce around $50 for three months. They never top $55, so it never pays for the owner of the option to buy Carl's shares. The call option expires unexercised.

Here, Carl's $180 income from selling the call would be 1.8% of his $10,000 investment in XYZ. He'd also collect the quarterly dividend, which might be, say, 0.5%, if XYZ pays a 2% annualized dividend. That's a 2.3% total return in a quarter of a year, or 9.2% annualized, while XYZ shares went nowhere. Going forward, with the option not exercised, Carl can write another call on the shares of XYZ he still owns.

This is a simplified, hypothetical example. Trading costs aren't included, for one thing. Nevertheless, a "buy-write" strategy might produce desirable results if stocks are in a trading range.

Up market

In another scenario, XYZ shares break above the $55 exercise price, and the call options are exercised. As this is a "covered" call, Carl can fulfill his obligation under the option contract by delivering the 200 shares of XYZ that he owns.

Here, Carl gets a 10% return ($5 profit after buying at $50 per share), plus the 1.8% return from selling the call, and perhaps the quarterly dividend, as well. Not a bad profit for holding this stock for three months.

Of course, XYZ might zoom past $55 to $60 or $65, and Carl would miss out on a greater profit after relinquishing his shares. That's a key disadvantage to this strategy.

Down market

Carl's shares of XYZ might plummet because of company news or a broad stock retreat. The $180 in cash from selling the call would be scant consolation if his $10,000 outlay drops to $9,500 or $9,000

Did you know

In a recent survey of U.S. consumers, 26% of respondents reported owning a digital assistant such as Google Home, Amazon's Echo/Dot (Alexa), and Microsoft's Cortana. They are primarily used for questions and answers, music, and entertainment. Financial institutions are starting to tap into the ability of intelligent personal assistants to access accounts to verify balances and make transfers.

Source: Total System Services

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or lower. Carl could sell another call, after the option expiration, pocketing more income but still bearing most of the stock's exposure to loss.

Go with the pros

The market for listed call options can be complex. Should you sell an "out-of-the-money" call, as Carl did? An at-the-money-call (exercise price equals current trading price)? An in-the-money call (lower exercise price)? Take a close or distant expiration date? Buy back the call you've sold because you decide to keep your shares?

Investors may like the concept of using covered calls but might be reluctant to make all the necessary decisions. This has led to the creation of buy-write funds. With these vehicles, financial professionals decide which assets to purchase and which options to sell, covered by holdings in the fund.

There are many forms of covered call and buy-write funds, with different methods of squeezing income from selling options. Tax treatment also can vary because some of these funds make distributions that are part long-term capital gain, part short-term capital gain, and part untaxed return of principal. If you're interested in such a fund, determine how your money will be invested.

Bond ladders may hedge interest rate hikes

Just as volatility and high prices might make some investors leery of stocks now (see "Buy-write strategies for a flat market"), the threat of rising interest rates may worry fixed income investors. Rising rates tend to depress bond prices.

Again, a time-tested strategy might be useful in the current environment. You could put together a bond ladder to hold the fixed income portion of your asset allocation. A ladder might consist of many individual issues with staggered maturities. As the nearest "rung" on your ladder is redeemed, the proceeds are reinvested in a bond with a longer maturity.

Example 1: Paula Morris decides to allocate $200,000 of her fixed income holdings to a bond ladder. She invests $25,000 in bonds maturing in 2019, $25,000 in bonds expiring in 2020, and so on, out to 2026. Typically, the longer the maturity, the higher the bonds' yields and the greater the exposure to price drops if interest rates rise.

When the bonds that make up Paula's 2019 rung are redeemed at maturity, she invests the $25,000 proceeds in bonds maturing in 2027, and so on, year after year.

Flex plan

With such a ladder, Paula will have $25,000 worth of bonds maturing each year. If interest rates rise in the future, as many observers expect, Paula will be able to buy higher yielding bonds, raising her periodic cash flow from investment interest.

Conversely, interest rates might surprise the "experts" and move lower. Paula will be re-investing at a lower yield, it's true, but she likely will be glad that she has locked in higher-than-current yields with her bonds on the later rungs.

Ultimately, Paula will wind up with a ladder that comprises bonds that were all bought at 8-year maturities. Historically, that has been a relatively attractive place on what is known as the *yield curve*, a plot of yields and maturities. Eight-year bonds often have yields much greater than those of very short-term bonds as well as moderate exposure to rising rates. That is, a bond issued with an 8-year maturity may not suffer a price drop as steep as a 10- or 20-year bond will experience, if interest rates trend much higher.

Trusted advice

Bond premium taxation

- If you pay more than face value to buy tax-exempt bonds, you must amortize the premium each year. The amount of the tax-exempt interest from the bonds that you report on your tax return is reduced by the amortized amount.
- Amortization of the premium reduces your basis in the bond by the amortized amount; the amortized amount is not deductible.
- If you pay more than face value to buy taxable bonds, you can choose to amortize the premium. If you choose to do so, the amortized amount is deductible, and your basis in the bonds is reduced by the amortized amount.
- If you choose not to amortize the premium on taxable bonds, the premium will create a tax loss when the bonds are redeemed at face value.

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Taxable or tax-exempt

Investors often use tax-exempt municipal bonds for their bond ladders. If so, the bond ladder should be held in a regular taxable account to take advantage of the tax break. Bonds issued within the buyer's state of residence often avoid state or local income tax as well as federal tax.

For IRAs and other tax-deferred retirement accounts, bond ladders generally should be constructed from corporate bonds or other taxable issues. Yields generally are higher than they are in comparable municipal bonds, and those yields can compound inside the tax-deferred plan.

Either way, if you are building a bond ladder now, buying existing, rather than newly issued, bonds, be aware that older bonds generally trade at a premium because they have higher yields than today's new issues.

Example 2: When Paula puts together her bond ladder, she pays $27,500 to buy bonds maturing in 2026 with a face value of $25,000. She builds in a $2,500 loss in return for receiving above-market yields for the next eight years, up until maturity.

You shouldn't expect huge profits from a bond ladder. Instead, you should consider a bond ladder as an arrangement that could possibly improve portfolio income and stability over a long period of time. Every year, you can expect an untaxed bond redemption that you can spend or save as you choose.

Tax calendar

OCTOBER 2018

October 15

Individuals. If you have an automatic six-month extension to file your income tax return for 2017, file Form 1040, 1040A, or 1040EZ and pay any tax, interest, and penalties due.

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

Corporations. File a 2017 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 6-month extension.

October 31

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the third quarter of 2018. Deposit any undeposited tax under the accuracy of deposit rules. (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.

NOVEMBER 2018

Employers. Ask employees whose withholding allowances will be different in 2019 to fill out a new Form W-4 or Form W-4(SP). The 2019 revision of Form W-4 will be available by mid-December at www.IRS.gov/FormW4.

November 13

Employers. For Social Security, Medicare, and withheld income tax, file Form 941 for the third quarter of 2018. This due date applies only if you deposited the tax for the quarter in full and on time.

November 15

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

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Citation and resource guide

Supreme Court decision in *Wayfair* affects online sellers

The Supreme Court's opinion in *South Dakota v. Wayfair, Inc.*, 6/21/18, can be found at www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf.

Buy-write strategies for a flat market

The IRS explains the tax treatment of covered calls on page 59 of IRS Publication 550, "Investment Income and Expenses," at www.irs.gov/pub/irs-pdf/p550.pdf.

Bond ladders may hedge interest rate hikes

For an explanation of bond premium amortization, go to page 33 of IRS Publication 550, "Investment Income and Expenses," at www.irs.gov/pub/irs-pdf/p550.pdf.

Practice development tip

Urge clients to enroll in Medicare on time

Full retirement age for Social Security benefits is now 66 or older. Therefore, clients may miss the importance of enrolling in Medicare at age 65.

A delay can be costly. The standard monthly premium for Medicare Part B, which covers medical costs such as doctor bills, is $134 a month this year. High-income seniors pay as much as $428.60 a month. Those who enroll in Part B after their initial eligibility pay a 10% penalty for each year they delay. This penalty goes on indefinitely, as long as someone is covered by Medicare Part B.

Example: Mary Warner waits 2 full years after her initial enrollment period before enrolling in Part B. (This period begins 3 months before and ends 3 months after the month someone reaches age 65.) Mary will have to pay a 10% penalty for each of these 2-year periods, resulting in a 20% penalty.

Assume that Mary would owe a $150 monthly Part B premium without a penalty. She would have to pay $180 a month: 20% more. This 20% penalty would last for as long as Mary has Part B coverage. If she had delayed her enrollment for only 23 months, she would, instead, have to pay only a 10% monthly penalty because only 1 full-year period of delay was involved.

Employer coverage

As explained, missing the deadline for penalty-free enrollment in Part B can be costly. There is an exception for those covered by a qualified group health plan based on current employment.

You should emphasize to clients that this exception applies if the employer has 20 or more employees. People with such group health coverage may be able to delay enrolling in Part B (and Part A for hospital coverage, as well), yet avoid a lifelong penalty if they enroll within 8 months after that coverage ceases.

That's not the case, though, if the group health coverage comes from an employer with fewer than 20 employees. Medicare advises people with coverage through these small group health plans to sign up for Part A and Part B when they are first eligible.

You can pass on this advice to clients who have health coverage through such small businesses. Signing up for Medicare Part B when first eligible can spare them a lifetime of unnecessarily expensive premiums.

Practice development and management resources from the AICPA

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

AICPA Personal Financial Planning Summit— January 7–9, 2019

The AICPA PFP Summit is a deeper dive into critical topics for personal financial planners and CPAs. Join this gathering of the most curious and experienced minds in wealth management to discuss challenging topics in the profession. Now through November 30, non-members are eligible to register at the member rate!

If you have any questions prior to registering, please call 888.777.7077 or visit www.AICPAStore.com/PFPSummit2019 for more details.

AICPA Personal Financial Planning Membership Section

The AICPA Personal Financial Planning Section membership is voluntary for CPAs and other professionals who provide personal financial planning services to individuals and families. The PFP Section member benefits include *The CPA's Guide to Financial and Estate Planning*, among numerous practice guides, as well as free web seminars led by renowned experts, award-winning newsletters like *Planner*, and invaluable networking opportunities with CPAs around the country.

[Item no. 03-NEW-2018 —AICPA Member $99.00]

AICPA PCPS/CPA.com MAP Survey National Summary

The 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]

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