ABC Bookkeeping And Tax Services
145 S D ST
Exeter, CA 93221
Phone: (559) 592-6400
Fax: (559) 592-6449

A tax, business, and financial planning newsletter for our clients and friends

Lower Education Expenses By Making Them Deductible

One of the biggest expenses most people will face during their lifetime is the cost of education, both for their children and for themselves. However, with a little creative planning, you can lower those education expenses with some help from the IRS.

Your children's education

Buy a second home for your child to live in at college. Instead of paying housing expenses to a college or paying rent to a landlord, your child can live in your second home. If it is your only second residence, you can take several deductions.

- You can deduct the interest on the mortgage for your second home as long as the total of the mortgages on your primary residence and your second residence is not more than $750,000 ($375,000 if married filing separately). You must use the mortgage proceeds to buy, build, or improve the home.
- The deduction for home equity loans is no longer deductible as an itemized deduction.

Buy rental property for your child to live in at college.

If your child pays you a fair market rent and you actively manage the property yourself, you can deduct your property taxes, maintenance, repairs, depreciation, utilities, and other expenses from your rental income. The maximum rental losses you may deduct is $25,000 if your Adjusted Gross Income does not

exceed $100,000. If your Adjusted Gross Income is between $100,001 and $150,000, the $25,000 maximum deduction is phased out.

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CLIENT'S tax & financial UPDATE
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taxPOINTS

Lower corporate tax rates. For corporations whose tax year begins after December 31, 2017, the graduated corporate tax rates are eliminated and taxable income is taxed at a flat rate of 21%.

Loophole: Life insurance. A business may provide tax-free to their employees up to $50,000 of life insurance. If more than $50,000 of insurance is provided a portion of the premium is treated as taxable income to the employee.

Loophole: Tax-free loans from your pension or profit-sharing plan. The borrowed money is not treated as income for tax purposes. **Caution:** The plan must permit borrowing. Review your plan documents beforehand.

Expensing election. Businesses can elect to expense as an option to depreciating over time $1 million of equipment placed in service. This is often referred to as the Section 179 deduction. The election phases out for businesses with more than $2.5 of equipment purchased in a year.

Combined Payrolls Can Produce Tax Savings

It's not unusual for closely-held corporations to operate through more than one division and for key employees to be on the payroll of both. If an employee's combined salary from each corporation total more than $128,400 excess Social Security taxes might be paid.

There's a way to avoid this problem. Instead of each corporation issuing its own payroll check, designate one company in the group as a common paymaster, which can issue one check to the employee on behalf of all the companies involved. To do this, you must meet one of these three criteria:

- The corporations involved must have at least 50% common ownership.
- Half or more of the officers of one corporation must also be officers of another.
- The corporations must share at least 30% of their employees.

The result? Let's say an employee is drawing a $100,000 annual salary from each of two corporations. Since the maximum Social Security tax is owed on the first $128,400 paid by each employer, the company will have to pay social security taxes on $200,000 of payroll. If a single check from the common paymaster company is issued, $71,600 of the total amount will be exempt from Social Security taxes.

Four Ways To Lower Your Borrowing Costs

It's widely acknowledged that bank credit standards vary among banks and that, even with one bank, its credit policy will vary depending upon changing economic conditions. Coupled with the cost of borrowing, tougher credit standards mean you should make every effort to keep your borrowing requirements down. But when you do have to borrow, here are four tips to help you keep the cost of borrowing to a minimum.

1. Negotiate interest rates. Not all banks will immediately quote their lowest rate. If you can't get a somewhat better rate by asking a few questions, it might pay you to shop around – preferably with your bank's biggest competitor.

2. Don't borrow more than you need. In most cases, the best strategy is to establish a line of credit for a given period of time. However, be sure to keep a close watch on the fee the lender charges for the unused portion of your line of credit. The typical charge often varies among banks.

3. If you have a solid relationship with a loan officer, stay with that bank. This is particularly important as credit standards become tighter. When a loan officer sees that your financial management history has been good over a period of time, your credit standing is greatly enhanced.

4. When your cash flow is good, consider prepaying a loan. This simple strategy can improve your credit standing, save you money, and enhance the lender's opinion of your ability to manage money.

How To Increase Profits By Cutting Prices

Although lowering your prices usually means that you'll sacrifice profits, selective price cuts can attract business you might not get at your regular prices. That business is incremental and can mean increased profits.

The key to profitable price cutting is to offer lower prices only to those customers who won't buy at regular prices or to those customers whose volume makes them major contributors to your profits. Selective price cutting for these two kinds of customers requires some thought and planning, but the payoff can be big.

Strategy #1: Identify price-sensitive customers and reduce prices for them

Cutting prices for first-time buyers often creates enough new sales to justify the lower prices. For example, many concert promoters realize that young people can't afford to pay the regular ticket price. Instead of lowering ticket prices to everyone, they offer discount prices to students.

While it's easy to selectively identify students because they carry ID cards, it's more difficult for other types of businesses to identify price-sensitive customers. You can't ask customers if they are price-sensitive because very few would give you an honest answer.

The proper way to do this is to determine the buying habits and product preferences that influence a customer's sensitivity to price. Walk into any automobile dealer showroom and you'll see this strategy in action.

Skilled automobile salespeople will quickly engage you in what appears to be a casual conversation. Within minutes they'll find out what you do for a living, where you live, and what kind of car you presently own. From what you tell them, they'll have a very good idea about what kind of deal to offer: a low price on a "stripped" car, a high trade-in allowance on your old car, a lease instead of a purchase, or perhaps an extended warranty.

The best time to make plans for price-sensitive customers is when you are developing a new product or service. Include certain features in your new product that are very important to your least price-sensitive customers who won't buy at your regular prices.

Strategy #2: Reduce prices on items that are important to your biggest customers

The most obvious use of this strategy can be seen in supermarkets, whose profits depend on their ability to attract shoppers with large families. Instead of pricing all items for a similar profit, supermarkets will offer sharply reduced prices on items which are important to large-family shoppers - sandwich bread, eggs, peanut butter, and beverages. Supermarket operators know that while large-family shoppers are in the store, they'll also buy items which have better profit margins.

Strategy #3: Beat "favored customer" agreements

In industrial markets, pricing is so critical that many companies demand that their suppliers sign a "most favored customer" contract. These contracts are an agreement by the supplier to give the customer the lower price for a specific product. Vendors often have no choice but to sign these contracts if they want to sell to large companies.

You can avoid the constraints of a most favored customer contract by making some minor changes in a product and selling it to others at a lower price and by marketing a version of the product that "more favored customer" won't want.

The critical element in profitable price-cutting is selectivity. Across-the-board price cuts are rarely the answer to improve profits.

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Lower Education Expenses By Making Them Deductible (continued)

Student loans

The maximum deductible amount of interest on education loans is $2,500. Deductibility is based on income. The deduction is phased out if modified adjusted gross income exceeds $65,000 ($135,000 for joint returns.)

American opportunity tax credit

The American opportunity tax credit, is available to taxpayers who paid tuition and other expenses for an eligible student. The amount of the credit is 100% of the tuition and related expenses paid by the taxpayer during the tax year for education furnished to the eligible student during any academic period beginning in the tax year up to $2,000, and 25% of the next $2,000 of the same expenses, for a maximum credit of $2,500.

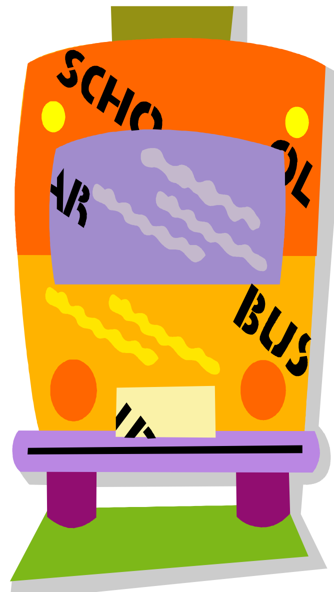
Tuition, required enrollment fees, books and other required course materials generally qualify, and eligible students must be enrolled at least half-time.

The American opportunity credit is allowed for four tax years per student, and for the first four years of post-secondary education at an eligible educational institution. Even taxpayers who owe no tax can get a payment of the credit of up to $1,000 for each eligible student.

Lifetime Learning tax credit

The Lifetime Learning Credit is available to taxpayers who paid tuition and other expenses for an eligible student. The amount of the credit is 20% of the first $10,000 of tuition and related expenses paid by the taxpayer during the tax year for education furnished to an eligible student. The maximum credit is $2,000 per tax return. The credit can be used to pay your tax.

Tuition, required enrollment fees, books and other required course materials generally qualify, and eligible students must be enrolled for at least one academic period beginning in the tax year.



Tax Tips

Inherited Property

If you sell inherited property at a loss, you can deduct the loss on your tax return.

Example: Your parents leave you a house with an original purchase price of $100,000, and a market value of $300,000. You inherit the house estate tax free, receive a "stepped-up" basis of $300,000, and hold it as an investment (you do not live in it). When you sell the house for, say, $260,000, you can deduct the loss of $40,000, subject to annual loss deduction limits. Capital losses are deductible dollar for dollar against capital gains and any excess losses can offset up to $3,000 of ordinary income each year. Excess losses are carried forward to subsequent tax years.

Added benefit: The loss is deductible even if it is created by brokerage commission payments.