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Make the RMD from Your Traditional IRA Tax-Free

Once you turn age 70 1/2, the tax code mandates that you withdraw a tax code–defined required minimum distribution (RMD) from your traditional IRA.

But by using the RMD or other IRA distribution with a qualified charitable distribution (QCD), you can eliminate the RMD tax bite, possibly reduce your Medicare premiums, possibly reduce the income taxes on your Social Security benefits, and more.

After you reach age 70 1/2, the tax code allows you to donate directly from your IRA account up to $100,000 per year in QCDs.

- The QCD-donated money escapes income taxes and also does not count as adjusted gross income (AGI).
- The QCDs can satisfy all or part of your RMD requirement.
- The QCD doesn't bump up against the mandated ceiling—50 percent of AGI—that applies to cash donations.

You likely will want to use the QCD if you donate money to your church, a school, or some other 501(c)(3) organization, such as the Red Cross or the American Cancer Society.

Rule 1. Make your QCD donation to a qualifying 501(c)(3) organization, such as your church, a school, or the Red Cross. Your QCD cannot go to a private foundation, a donor-advised fund, or a charitable supporting organization.

Rule 2. Don't touch the money. The trustee must make the check or transfer payable to the charity (not to you).

Double dip. You get a double-dip benefit when you don't itemize deductions and you contribute directly from your IRA to a charity.

- First, you get the benefit of the standard deduction.
- Second, you get the benefit of the direct charitable contribution deduction because it cancels your RMD income, making the RMD tax-free.

To put this another way, with the IRA-to-charity contribution, you (the non-itemizing taxpayer) create a deduction where none existed before. And these days, because of the Tax Cuts and Jobs Act, you are less likely to itemize.

Save on Medicare premiums. The government bases the Medicare premiums that you pay on the AGI reported on your tax return two years ago (e.g., your 2019 payments are based on your 2017 tax return). To see how you can save, consider this:

- If you take the IRA money directly, it adds to your AGI, which can increase your Medicare premium costs in 2019.
- If you use the QCD method, you add nothing to your AGI.

Pay less tax on your Social Security benefits. Before 1984, you paid no income taxes on your Social Security benefits. Today, you have to add together your AGI, your tax-exempt income, and half of your Social Security benefits, and then pay taxes at your regular tax rate on

- 50 percent of the Social Security benefit, if the computed amount is between $25,000 and $34,000 ($32,000 and $44,000 for joint returns), and
- 85 percent of the Social Security benefit, if the computed amount exceeds $34,000 ($44,000 for joint returns).

The taxable RMD adds to your AGI and can make more of your Social Security benefits taxable.

Solution. Avoid the RMD taxable income inclusion with the direct IRA-to-charity donation, and that, in turn, can cut the taxes you are paying on your Social Security benefits.

Shrink the net investment income tax (NIIT). You pay the 3.8 percent NIIT on investment income when your modified AGI is greater than $200,000 ($250,000 for joint returns).

Would your required IRA RMD add to your AGI and make you subject to this tax? If so, consider making the RMD disappear with the direct IRA-to-charity strategy because this lowers your AGI.

Take Advantage of the 199A Deduction for 2019

If you operate your business as a pass-through entity, such as a proprietorship, partnership, or S corporation, the profits of that business can generate the Section 199A tax deduction.

No-Problem Businesses

You qualify for the Section 199A deduction—period, regardless of pass-through business type—when you have

- pass-through qualified business income (QBI), and
- 2019 Form 1040 taxable income equal to or less than $160,700 single (and head of household) or $321,400 married, filing jointly.

With Form 1040 taxable income equal to or less than the thresholds listed above, doctors, lawyers, accountants, financial planners, stockbrokers, manufacturers, retailers, consultants, and all other businesses with pass-through income qualify for the deduction.

There's no out-of-favor specified service business problem with income below the thresholds.And the calculation is easy.

With taxable income equal to or less than the thresholds, you qualify for the Section 199A deduction. Your deduction will equal the lesser of

- 20 percent of your Form 1040 taxable income less net capital gains and dividends, or
- 20 percent of your QBI.

Note that *qualification* for the deduction starts with your Form 1040 taxable income.

Example. You are married with joint taxable income of $320,000 and QBI of $350,000. Your Section 199A deduction is $64,000.

As you can see, no issues. If your taxable income is above the thresholds, you need to consider tax planning—now. Why now? Because some strategies require that you have time on your side.

For example, if you switch from a proprietorship to an S corporation to benefit from the W-2 wage strategy, your switch does not begin until you have the S corporation in place.

If you are looking at a retirement plan strategy, you want time to consider your options and get that tax-savings plan in place.

How Corporations Reduce IRS Audits of Home-Office Deductions

If you filed your business income and expenses as a proprietor in 2017 and reported $100,000 or more in gross receipts, your chances of IRS audit were 2.4 percent (2017 returns are still open for audit, so the percentage could increase).Had you reported this income as an S corporation, your chances of audit were only 0.20 percent.

You have probably read that the home-office deduction increases your chances of IRS audit. We've read that, too, but we don't believe it. Regardless, let's assume that you're a little paranoid about audits, and you want to claim the home-office deduction in a way that doesn't attract the attention of the IRS.

If you operate as a corporation, your home-office deduction does not show on either your personal return or your corporate return if you have the corporation reimburse the office as an employee business expense.

With reimbursement, the corporation claims the deduction for the expenses it reimburses to you. The corporation probably puts the reimbursement into a category called "office expenses" or something similar. Thus, the home-office deduction as a name or title does not appear in the corporate return.

You receive the reimbursement from the corporation as a reimbursed employee expense. You do not report employee-expense reimbursements as taxable income on your personal return. Thus, you do not identify the home office on your personal return.

With this method, the home-office deduction does not appear under a home-office label on either the corporate or personal tax return.

Act Fast to Claim a 30 Percent Tax Credit for Residential Solar Panels

Here's a heads-up.The 30 percent residential solar credit

- drops to 26 percent for tax year 2020,
- drops to 22 percent for tax year 2021, and
- terminates in 2022.

Also, unlike the 30 percent commercial solar credit, where you can qualify for the 30 percent tax credit when you commence construction (as defined by the IRS, but easy to do), your 30 percent residential credit is granted when you place the solar property in service.

If you are thinking of the 30 percent tax credit for a solar installation on a residence you own, don't let the time slip away, because you must have the solar property in use before December 31 to qualify for the 30 percent tax credit (dollar for dollar).

Be Aware of Tax Issues While Working Abroad

Here are three quick things to know about working abroad.

Issue 1: Section 199A

To qualify for the Section 199A deduction, your business income must be effectively connected with the conduct of a trade or business within the United States.The preamble to the proposed Section 199A regulations clarified that in almost all circumstances, this means the income has to be U.S.-source income to qualify.

Under the tax law, you source your compensation for personal services based on where you perform the services.

For example, you perform all services for U.S. citizens living in the United States from your office in Norway. The services for the U.S.-based citizens do not generate U.S.-source income; therefore, you do not qualify for the Section 199A tax deduction.

Issue 2: Income Tax

You have two ways to reduce or eliminate the U.S. income tax on your foreign-source income:

- Foreign earned income exclusion
- Foreign tax credit

The only way you'll know for sure is to calculate your return using both methods and pick the one with the better outcome.

Issue 3: Self-Employment Tax

If you file a Schedule C, you already know you need to pay self-employment tax on your net Schedule C income.However, the U.S. has totalization agreements with certain countries to avoid double Social Security taxation. These agreements usually apply to self-employed individuals.

The IRS expects to see self-employment tax when there is a Schedule C on a tax return, so be sure to do the following:

- Get a Certificate of Coverage from the country where you reside, to help prove to the IRS you are exempt from self-employment tax.
- File Form 8275, Disclosure Statement, with your tax return to disclose the position that you are exempt from self-employment tax due to the totalization agreement.

Warning

If you have an interest in or signature authority over foreign financial accounts or other foreign financial assets, you may have to file special forms in addition to your tax return.

If you don't file the forms but had a filing requirement, the penalties could be severe: as high as $10,000 per form per year.