Individual Income Tax Newsletter

Winter 2016 / 2017

Well, other than a new president who will most likely push through some major corporate and individual tax changes, and do away with most or all of the Affordable Care Act, we are looking for a pretty boring and calm 2017. You may be snickering, shivering or jumping with glee… but yes, in reality the couple of years we have had without major tax law changes (especially those maddening changes at the very end of the year) should soon be a distant memory. We don't plan to guess what's coming, but we do plan to share with you a variety of tax topics that you should be aware of. Most of these will be explained with the intent of providing you with an awareness of tax concepts, saving more in-depth specifics for your own questions or planning.

As always, the last page of this newsletter contains our favorite answers to last year's Tax Organizer Questionnaire Contest. It involved a very generic political question, but the answers are fun to review now that the election is actually over.

Trump Tax Plan

Recapped from a Wall Street Journal article, this is an initial discussion of proposed changes that could change again many times over. But here are some early key components:

Standard deduction will be increased in order to limit the number of taxpayers having to itemize deductions.
Tax rates will be reduced from seven rates to three; lowering of the top income tax rate from 39.6% to 33%.
AMT (Alternative Minimum Tax) could be eliminated... you wouldn't see any tears in our office!
Capital gain rates could remain the same or be reduced.

2016 Tax Return Changes

<u>Due Diligence Requirements</u>: As CPA's, more and more the IRS is relying on us to do their "auditing". In some cases, if we fail to perform this due diligence, we could be liable for harsh tax preparer penalties. This threat is their approach to having us make it less necessary for them to audit returns that contain often-abused areas. Here are the areas that we will be required to perform more inquiry or get more documentation before finalizing client tax returns (this due diligence tax form will be attached to the income tax filing):

Earned income credit (FYI, the IRS will not send out any refunds with the EIC before February 15 this year).
Educational tuition credits (colleges will be required to show the amount paid for tuition this year and not just the amount "billed", which is the main reason the IRS is challenging many previous education credits).
Additional child tax credit (this is the "refundable" portion of the child tax credit, for those who do NOT otherwise have a tax liability).

Also, for **new clients** we will be required to review and copy government issued ID before filing their return.

ACA (Affordable Care Act) Penalties

For those taxpayers who do not have minimum essential health insurance coverage and do not fall into the possible exemption categories, the penalty is increasing again this year. Expect this scenario to change with the probable overhaul of this Act with the new administration, but most likely changes will affect 2017 taxes.

Penalties for lack of coverage (calculated on a month by month basis) increases *to the higher of*:

$695 per person; for example, a couple without dependents filing jointly could be a $1,390 penalty.
2.5% of Adjusted Gross Income (AGI); for example, $150,000 AGI would equate to a $3,750 penalty.

Penalties and Collections

Penalties are meant to spur compliance with tax filing requirements, but when increased to unfathomable amounts and used as a revenue raiser (rather than raising taxes), well, one could argue whether there is more compliance or less. Here is a little commentary about how and why to avoid these onerous penalties.

Avoid underpayment penalties (when owing more than $1,000 in federal income tax on the tax return) by:

1. Having at least 90% of total tax liability for the year paid in timely during the tax year.
2. Cover at least 100% of your prior year total tax liability with withholdings and/or timely and sufficient quarterly estimated tax payments (110% for AGI over $150,000).

If <u>quarterly estimated tax payments</u> are required, they must be <u>timely and sufficient</u> to totally avoid underpayment penalties.
<u>Income tax withholdings</u> can be heavily loaded late in the year and still be considered as received timely throughout the year (this allows for catching up on the required amount via payroll withholdings).

In some cases, when there is an underpayment penalty due to insufficient or late quarterly estimated taxes paid in, taxpayers may be able to minimize or eliminate the penalty by "annualizing" their income. This is a fairly complex tax form that shows the IRS that large portions of taxable income came late in the tax year, hence it would have been impossible to pay sufficient tax early in the year with this timing uncertainty.

There are times when this underpayment penalty (*or most penalties* for that matter) can be reduced or abated with a "reasonable cause" excuse. If the taxpayer had a casualty (including health), disaster, or other unusual circumstance and it would be inequitable to assess a penalty, a penalty waiver should be filed with the IRS. Also, if taxpayers retired or became disabled, had reasonable cause for not making a tax payment, and it wasn't due to willful neglect, their chance of a penalty waiver is good. The waiver request must be in writing. We are certainly able to assist or guide our clients with these requests.

NOTE: As always, the penalties for not paying tax in timely can be painful, but when nonpayment is also matched up with LATE FILING of a tax return, the penalties can become downright dastardly. Our advice is to ALWAYS try to file timely, even if you can't pay all of the tax. The IRS will bill you what you owe within a month or so, but that gives you time to come up with more funds to cover the tax bill, or to contact the IRS for a payment plan. But you may have saved hundreds or thousands by at least filing the tax return timely.

Assortment of Tax Tidbits

1. **Alimony** is taxable to the recipient, and deductible by the payer. **Child support** is NOT taxable to the recipient and NOT deductible by the payer. Also, alimony can be used by a recipient to qualify for investing in an IRA (for example if the recipient does not otherwise have wages or earned income).

2. **Foreign income and assets** can create a variety of tax reporting requirements, and ignoring the rules can generate penalties of half of your foreign account balance. If at any time during a tax year a taxpayer has a foreign investment that is at least $10,000 at ANY time during the year, there is a tax return form that is required. This question is on our Tax Organizer Questionnaire… don't take it lightly.

3. **Required minimum distributions (RMD)** <u>from an IRA</u> can be directly sent to a charity (a law that was made permanent with the last tax act) rather than taking the distribution personally and then writing a check to the charity. There could be some excellent tax opportunities with this, because you don't have to include the distribution from the IRA in your income. This could result in a nice tax savings for someone who uses the standard deduction rather than itemized deductions. This is certainly a case by case scenario, so a tax planning discussion would be warranted.

4. **Early distribution from retirement plans** can cause a 10% early withdrawal penalty. When this penalty is added to the federal and state income tax from the distribution, taxpayers are often shocked to find out any withholding they did have was very insufficient. There are multiple exceptions that void this penalty, some of which apply to only IRA's, some to only 401k's and other qualified plans, and some to both. Some common uses of these exceptions are for first time home buyers, education costs, certain medical expenses, death or disability, and more. ADVICE: Don't take this decision to draw from your retirement before 59.5 years of age lightly. Consider all other funding options, the status of your current year tax situation, what the funds will be used for, and protecting your own retirement scenario. We can help with this analysis by preparing a tax projection and offering ways to avoid or minimize the tax, penalty and surprise factors of this decision.

5. **New economy tax issues**… we're talking about Uber/Lyft taxi services, Airbnb home rental, Go Fund Me accounts, Kickstarter or Indiegogo, etc. The tax reporting and rules of these new-age business and fund raising websites and activities is evolving, but we do have *some* written guidance on most of it. Some of it we have to use our professional judgement and training on. Others, like Bitcoin, have not yet garnered any tax and accounting guidance from Congress or the IRS. So if you are getting involved in these new economy activities, we can share with you how we will be handling the tax reporting.

Scam alert

It never hurts to have this annual reminder: The IRS will NEVER send you an email, never threaten you over the phone for payment, or seek personal information to make a payment on a tax due (unless you have contacted them with an ongoing tax issue). Most of our clients, and us as well, have gotten the scamming email or phone call in the past year. Recent scams have included very authentic looking letters. Again, don't ever pay an unexpected tax bill, regardless of how small. Never give out personal information on the phone. Investigate the origin, check the IRS website for phone numbers, and call them to verify the authenticity of a request… or contact us to review the notice.

Annual Tax Organizer Questionnaire Contest (from last year)

As we do every year, we are again awarding a $50 gift card to the person with the best answer to our Organizer Questionnaire Contest. It seems appropriate, now that this year's election is over, that we can go back to last year's question and give you our favorite answers.

Question was: "Excluding any current presidential candidate seeking office in 2016, what NON-political person would you choose to run our country, and why?"

1. Siri… she has all the answers. (WINNER)
2. Mr. Ed the talking horse; everybody else is running. (Remember there were 20 candidates early on!)
3. Leonard (Big Bang Theory).
4. Michael J. Fox in "Back to the Future"… travel back to 1955 and change the political system.
5. Bozo, because politics is a circus.
6. Harpo Marx, because he doesn't say a word and is used to working with idiots.
7. Jim Harbaugh... multiple people had this answer. (Go Blue, even though the country went "Red").
8. Usain Bolt, because he has been trained to "Run".
9. Fred Gould, but only if he gets us a tax refund.
10. Ed Stinson, because he is a cultural Boomer with a sharp pencil.
11. Dave Comer… OK, Dave didn't get any votes but I thought I better put him in here also!
12. Dave Ramsey, because he encourages hard work, debt reduction and tells it like it is.
13. Whoever invented beer.
14. Richard Simmons… he could get our country in shape.
15. Morgan Freeman: three people chose him (he has played God in the movies and has a great voice).
16. Stephen Hawking, because he could validate the theory that all of our tax dollars go into a Black Hole.
17. Larry the Cable Guy… a sleeveless flannel clad president with the slogan "Git r Done".
18. Stephen Colbert, because he is smart, creative, well educated, and most of all, FUNNY.
19. Warren Buffet, the humble billionaire.
20. And, not sure if serious or tongue-in-cheek: "I would vote for my husband, because he knows all the answers"