# 2018 U.S. Income Tax Filing (TY2017)

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### Tax Law Basics - Who Must File \$ 11,950\* Single \$ 10,400 Married filing jointly Both spouses \$ 20,800 One spouse 65+ \$ 22,050\* Married filing separately \$ 4,050 \$ 4,050\* \$ 14.950\* Head of Household \$ 13,400 Qualifying Widow(er) ^ \$ 16,750 \$ 18,000\* \*Excludes Social Security ^with dependent children

# Tax Law Basics - Who Must File

- Owe additional taxes
- \$400 or more net self-employment income

# Tax Law Basics - Who Should File

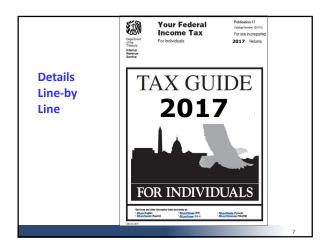
- Claiming refund of withheld taxes or estimated tax payments
- Claiming any refundable credit (credit independent of taxes owed)
  - Earned Income Credit
  - Additional Child Tax Credit
  - Education Credits
- Desire to help prevent identity theft

# Identity Theft (from prior year(s))

- IRS sends notices to taxpayers identified as victims (or potential victims)
- Notice provides Identity Protection PIN victim needs when filing 2017 tax return
- If received IP PIN but lost it, call ID Theft Toll-free Hotline: 800-908-4490

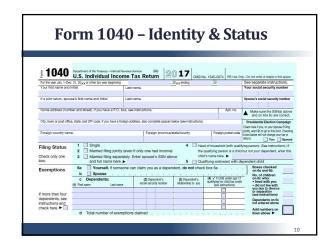
# **Taxpayer Responsibilities**

- Even if you have someone else prepare your return ...
  - It's your return and you are responsible for accuracy of all data provided
  - You must have accurate and complete records if audited by IRS

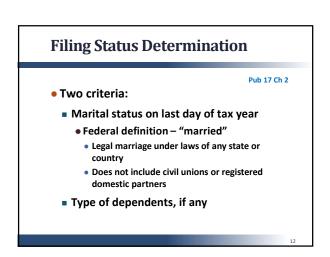




# Tax Law Basics – Form 1040 Identity, filing status and exemptions Income Adjustments (to income) Deductions and exemptions Tax and nonrefundable credits Additional taxes Refundable credits



# Five Choices for Filing Status • Married Filing Jointly (MFJ) Best • Qualifying Widow(er) (QW) 2<sup>nd</sup> with dependent children (not grandchildren) • Head of Household (HH) 3<sup>rd</sup> • Single 4<sup>th</sup> • Married Filing Separately (MFS) Worst



# **Living Situation Analysis**

- Marital status as of 12/31
- Others living in home, if any
  - Their relationship/dependency
  - Who paid upkeep
- If widow(er)
  - Date of death of spouse
  - Any dependent children at home

...

# **Filing Status Importance**

- Many tax items affected by filing status
  - Necessity to file a return
  - Standard deduction
  - Tax rate bracket
  - Eligibility for certain credits

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# **Married Filing Jointly**

- Married on last day of year
- Common law marriage
  - If recognized in state where started
- Spouse died during current year (2017 or 2018) and not remarried

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# Qualifying Widow(er)

- Spouse died in 2016 or 2015
  - Dependent child and/or stepchild lived in home all year
  - Grandchild not eligible
- Maintained home for child
  - >50% of cost
- Can file QW for two years only

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# Qualifying Widow(er)

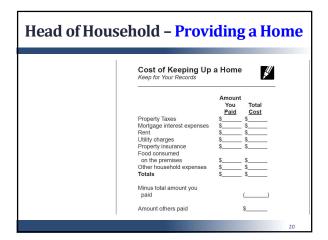
- Advantages
  - Standard Deduction same as MFJ
  - Uses Married File Jointly tax rates

Head of Household - Unmarried

- Provided home\* for qualified child
- Might not be a dependent
- Provided home\* for related dependent
- >50% cost of maintaining home for dependent parents living elsewhere
- \* Paid more than 50% of cost of keeping up the home

# Head of Household - Married

- Lived apart all of last 6 months of year
- Provided home\* for:
  - Child, stepchild, or eligible foster child for over six months
- No other relatives qualify
- \* Paid more than 50% of cost of keeping up the home



# Head of Household

- Key advantages
  - Higher standard deduction than **Single or Married Filing Separately**
  - Advantageous tax rate structure

# **Single**

- Not married as of December 31<sup>st</sup>, or
- Married, but legally separated
- No dependent children at home

# **Married Filing Separately**

- Taxpayer chooses to file MFS -OR-
- Spouse has already filed MFS -OR-
- Married but separated and not filing MFJ
- Rare cases more advantageous
  - Generally, no children in home
- TX is a community property state, therefore, this can be messy, and not recommended

Form 1040 - Income 7 Wages, salaries, tips, etc. Attach Form(s) W-2
8a Taxable interest, Attach Schedule B if required
b Tax-exempt interest. Do not include on line 8a
9a Ordinary dividends. Attach Schedule B if required Income 10 Taxable refunds, cradis, or offsets of states and local income taxes
11 Allmony received .
12 Business income or (loss). Attach Schedule C or C-EZ
13 Cepital gain or loss, attach Schedule C or C-EZ
14 Cother gains or losses, Attach Form 4797 .
15 RA distributions 15 Bis RA distributions 15 Enclose, but do not attach, any payment. Also, please use Form 1040-V.

# Where to Find Interest Income

- Form 1099-INT
- Sub 1099-INT (Brokerage Statement)
- Schedule K-1
- No tax form from payer
  - Seller financed mortgage interest income
  - Private or foreign payer
  - Interest less than \$10

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# **Interest Income**

- All interest is taxable except:
  - State or municipal obligations; including
    - \* D.C.
    - \* U.S. possessions See Pub 17, chapter 7
- U.S. obligations (T-Bills, Savings Bonds, etc.) are fully taxable for federal tax

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# Dividend Income - What is it?

- Payment by a corporation
- Paid to its shareholders
- Credit union dividends are <u>not</u> dividends, they are interest

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# **Dividend Income - What is it?**

- Mutual fund dividends
  - Dividend income from corporations
    - \* Will be identified as ordinary/qualified
  - Interest income from bonds/accounts
    - \* Will be identified as exempt if from exempt securities, e.g. state bonds
  - But both are still dividends to the fund's shareholders

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# **Dividend Income**

- Ordinary dividend income (not qualified)
  - Taxed at regular tax rates
- Qualified dividend income
  - A subset of Ordinary Dividends
  - Taxed at capital gain rates



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# Where to Find Dividend Income

- Form 1099-DIV
- Substitute 1099-DIV (brokerage or mutual fund statement)
- Schedule K-1

# **Dividend Income Reinvested**

- Reinvested dividends
  - Really, two transactions
    - \* Dividend income
    - \* Purchase of more shares
  - Payer effects both instantaneously
- ➤ Payers keep track of basis for covered securities (however, always taxpayer's responsibility to insure correctness)

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# **Dividend Income - Problems**

- 1. Payers of dividends of less than \$10 don't have to issue 1099 (true or false?)
  - True same rule as for interest payers
- 2. Taxpayers don't have to report dividends if they don't get a 1099 form (true or false?)
  - False all income must be reported on the tax return

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# **Dividend Income - Problems**

- 3. Dividends reinvested in more shares are not taxable (true or false)?
  - False the dividend income is the first transaction and the purchase of shares is a second transaction

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# **Earned Versus Unearned Income**

- Types of unearned income
  - Social security benefits
  - Retirement income
  - Unemployment compensation
  - Land rents
- Without earned income, no El Credit

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# **Alimony Received**

### What is Alimony?

- Spousal support under separation or divorce instrument
- Usually stops if recipient remarries, may stop sooner
- Not subject to change based on factors such as age of a child
  - Child/family support is NOT alimony

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# **Capital Gains / Losses**

- Ordinary income tax rates range from 10% to 39.6%
- Capital gain tax rates are much lower
  - Usually 0% or 15% rate
  - Could be 20% rate for very high incomes

# **Capital Asset Taxation**

- Capital gain tax rates apply to "net longterm gains" and qualified dividends
- Ordinary income rates apply to "net short-term gains"
- Capital gains or losses come from the sale of capital assets (stocks, bonds, etc.)

When is a Gain/Loss Not Reported

- Not reported if not a "sale or exchange"
  - A gift is not sale or exchange
  - Donation to charity is not sale or exchange
  - Bequest to heir is not sale or exchange

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Generally, nonbusiness assets

What is a Capital Asset

- Securities are capital assets
  - Stocks
  - Bonds
  - Mutual fund shares

"Sort-of" Capital Assets

- Homes and other non-investment assets
  - Capital assets for gains
  - Personal assets for losses (not deductible)
- ➤ Government is a profits-only partner!



# Sale of Principal Residence ("Main Home")

- Generally not a taxable event if:
  - Residence was main home
  - Taxpayer satisfies ownership and use tests
  - Gain less than \$250,000 (\$500,000 MFJ)
  - Taxpayer did not receive Form 1099-S

What is a Main Home

- Where taxpayer lives most of the time
- Can be houseboat, mobile home, condo or co-op
- Must have cooking, sleeping and bathroom facilities
- If more than one home, main home is one taxpayer lives in most of the time
- Taxpayer cannot simply "choose"

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# Sale of Main Home

- Report on tax return if
  - Any part of gain is taxable
  - Any time Form 1099-S is received

**Types of Retirement Income** 

- Pensions
- Annuities
- Social Security
- Individual Retirement Arrangement (IRA) Distributions

# **Retirement Income Reported on:**

- Form 1099-R Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, 401(k) plans, etc.
- Form RRB 1099-R Annuities or Pensions by the Railroad Retirement Board
- Form CSA 1099-R Statement of Annuity Paid (civil service retirement payments)
- Form CSF 1099-R Statement of Survivor Annuity Paid

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# "Pension" Distributions

- Reported on Forms
  - 1099-R company plans \*
  - RRB-1099-R (green) Railroad Benefit
  - CSA-1099-R civil service, government
  - \* Pension distributions include distributions from 401(k), 403(b) and 457(b) plans

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# Four Types of IRAs

Pub 17 Chapter 17

- Traditional
- Roth
- Savings Incentive Match Plans for Employees (SIMPLE)
- Simplified Employee Pension (SEP)

**Traditional IRA Distributions** 

- Regular (taxable)
- Required minimum distributions (RMD) (taxable)
- Trustee to trustee transfer (not taxable)
- Rollover (not taxable if done correctly)

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# **Traditional IRA Distributions**

- Fully taxable in the year taken
- Potential 10% additional tax for distribution prior to 59½ ("too early" penalty)
  - Exceptions may apply

**IRA RMD Distributions** 

Pub 17 Ch 17

- Required Minimum Distribution (RMD)
  - Must take required minimum distribution age 70½
  - Must take by April 1 of year following
  - Can avoid two distributions taxed in one year by taking first in year turning 70½

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# **Traditional IRA RMD**

- IRA administrator (trustee) <u>optionally</u> calculates RMD and notifies taxpayer of requirement and amount
- Taxpayer responsible to take RMD (either from one account or multiple accounts)
- 50% additional tax for amount not distributed ("too late" penalty)
- Can request waiver of additional tax using Form 5329 Part IX

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### **Roth IRA**

- Contributions not deductible
- Distributions tax free if conditions met
  - Pub 17, last page of chapter 17
  - Pub 590-B

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# **Qualified Roth IRA Distributions**

- No additional tax if:
  - Made after the five-year period beginning with first contribution -AND-
  - Made on or after age 59½ -OR-
  - Disabled -OR-
  - Death -OR-
  - To pay up to \$10,000 of certain qualified first-time homebuyer amounts

**Other Income** 

Pub 17, pg 94

- Gambling winnings including lotteries and raffles
- Reported on 1099-MISC, Box 3
- Reported on 1099-MISC, Box 7 (but "not a business")
- 1099-LTC
- Jury duty pay and Poll Worker Pay (not on W-2)
- Other:
- Prizes and awards
- Medical study subject pay
- Cancellation of credit card debt

# Long Term Care Payments 1099-LTC

- LTC Insurance Contracts
  - Generally reimbursements not taxable
  - Per diem costs up to an aggregate limit of \$330/day are non-taxable
- Reported to taxpayer on 1099-LTC
- Complete Form 8853, Section C

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# Accelerated Death Benefits 1099-LTC

- Insured has been certified by a physician as terminally ill
  - Fully excludible
- Certified as chronically ill
  - Treated the same as paid under a qualified long-term care insurance contract

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# Adjustments to Income

- Educator expenses
- Health Savings Account (HSA)
- Self-employment tax
- Early withdrawal penalty
- Alimony paid\*
- IRA contributions\*
- Student loan interest
- Tuition and Fees
- Jury duty pay given to employer
- \* Further Explanations

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# Alimony Paid - Line 31a

- Allowed if paid under Divorce/Separation
   Agreement
- Must provide recipient's Social Security No.
- Recipient must claim as income
- Child Support not deductible

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## IRA Deduction - Line 32

- Can contribute lesser of \$5,500 (\$6,500 if age 50-70½) or taxable compensation
- Taxable compensation
  - Wages, tips, bonuses, Sch C income, alimony
  - Not interest, dividends, pensions, unemployment, social security
- Taxpayer has until end of filing season to make contribution for current tax year
- Actual amount depends on Taxpayer / spouse retirement plans, modified AGI, age and filing status

Deductions

- Subtractions from a taxpayer's adjusted gross income (AGI)
- Reduces amount of income taxed
- Most taxpayers have a choice
  - Standard deduction
  - Itemizing deductions
- Use type of deduction that results in lower tax

## **Standard Deduction**

- Fixed reduction of AGI based on:
  - Filing status
  - Age (65 or older)
  - Blindness
  - Dependency
- Standard amounts change each year (indexed for inflation)

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# **Blindness**

- Totally blind taxpayer
- -OR-
- Certified statement from eye doctor that
  - Taxpayer cannot see better than 20/200 in the better eye with glasses or contact lenses -OR-
  - Field of vision is not more than 20 degrees

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# Possible Itemized Deductions (Schedule A)

- Medical or dental expenses paid
- Non-federal Taxes paid
- Interest paid
- Gifts to charity
- Casualty and theft losses
- Miscellaneous expenses subject to 2%
- Miscellaneous expenses not subject to 2%

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# **Medical Expenses**

- Medical expenses include
  - Diagnosis, cure, mitigation, treatment, or prevention of disease
  - Treatments affecting any part or function of body
  - Equipment, supplies, and diagnostic devices
  - Premiums for insurance that covers medical care
  - Long-term care insurance premiums (limited)
  - Transportation/travel to get medical care

# **Medical Expenses**

- Not all "medical expenses" qualify
- Examples of not qualified expenses:
  - Cosmetic surgery
  - Funeral or burial expenses
  - Nonprescription drugs (except insulin)
  - Weight loss program not prescribed
  - Diet food

Pub 17 Table 21-1; Pub 502

**Medical Expenses** 

- Must be paid during tax year by cash or credit card
  - Cannot be reimbursed expenses including expenses claimed for HSA
- Only for taxpayer, spouse, dependents
- 19¢/mile for travel for medical purposes

# **Medical Deduction - Problems**

Deductible medical expense?

Prescription sunglasses Yes

Contact lenses Yes

Dentist teeth whitening No

Gym fee (doctor suggested exercise) No

Dentist teeth cleaning Yes

# **Taxes**

- MUST be imposed on taxpayer
  - Can't pay someone else's taxes and claim it as a deduction
- MUST be paid in current tax year

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### **Taxes**

- State and local taxes
  - Income tax -OR-
  - General sales tax (TX normally)
- Real estate tax (U.S. or foreign)
- Personal property tax based on value
- Foreign income tax (if not claiming a credit)

# **Additional Sales Tax**

- Any large purchases?
  - Motor vehicle (car, motorcycle, motor home, off-road vehicle (golf cart), etc.)
  - Boat or airplane
  - Home, home addition or renovation
    - Sales tax must have been separately stated and paid by taxpayer (not the contractor)

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# **Taxes**

- Line 6 Real Estate (Property) Taxes
  - May be reported by mortgage company on Form 1098
  - For personal use, not for business use
  - The following are not deductible:
    - Itemized charges for services (such as trash pickup or sewer fees)
    - \* Transfer taxes (or stamp taxes)
    - \* Rent increases due to higher real estate taxes
    - \* Homeowners' association charges or dues

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# **Non-Deductible Taxes**

Pub 17, Table 22-1

- Federal income and excise taxes
- Social Security, Medicare
- Federal Unemployment (FUTA)
- Railroad retirement taxes (RRTA)
- Customs duties
- Federal estate and gift taxes

# **Home Mortgage Interest**

- Interest on loan secured by main home or second home
- Mortgage to buy or build home or second home (both limited)
- Home equity loan or line of credit (limited)
- Both taxpayer and lender must intend that loan be repaid

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# **Home Mortgage Interest**

- Points
  - Paid at loan origination
  - If to buy or build main home, deductible in full
  - Otherwise, spread over life of loan

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# **Home Mortgage Interest**

- Qualified home mortgage insurance premium (called PMI)
  - Must relate to home acquisition debt
  - Insurance contract issued after 2006
  - Sometimes not reported on Form 1098

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# Non-Deductible Interest / Fees

- Personal interest (e.g. car loan, line-of-credit)
- Service charges
- Annual fees for credit cards
- Loan fees
- Credit investigation fees
- Interest to purchase or carry tax-exempt securities
- Fines and penalties paid to a government for violations of law

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# **Gifts to Charity**

- Qualified charity
  - Churches, governments, schools, etc.
  - Approved by IRS
    - **\*** U.S. charity
    - \* irs.gov/charities for list
  - Limited to % of AGI
    - \* Public charity: <50% of AGI
    - \* Private foundations: <20% or 30% of AGI

**Gifts to Charity** 

- Monetary contribution less than \$250
  - Bank record (check, credit card or bank statement) or receipt
  - -OR-
  - Written acknowledgement from charity
- If payment is >\$75, charity must state value of goods/services provided, if any

# Gifts to Charity

- Monetary contribution \$250 or more
  - Written acknowledgement from charity
  - Must state value of goods or services provided in exchange for contribution, if any

e.g., fundraising dinner – value of dinner must be deducted from ticket price paid; only net amount deductible

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# **Gifts to Charity**

- Housing foreign exchange student
  - May deduct up to \$50 per month
- Foster child unreimbursed expenses

Pub 17, Chapter 24

# **Gifts to Charity**

- Donations of clothing or household items
  - Deduct fair market value
    - \* Usually thrift store value
  - Good used condition or better
- Capital gain or business property donations
- Car, boat, or plane donations

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# **Gifts to Charity**

- Out-of-pocket expenses are also deductible
  - Mileage @ 14¢/mi
  - Tolls and parking
  - Out of pocket expenses when serving as volunteer for qualified charity (e.g., hospital volunteer uniform)

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# **Non-Cash Contributions**

- Need receipt for all non-cash donations
- Single non-cash gifts \$250 or more
  - Written acknowledgement from charity
- More than \$500
  - Complete Form 8283 Section A, Part 1 only
- Should always keep detailed list of items donated (pictures help)

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# **Non-Deductible Contributions**

- Contributions to following types of organizations:
  - Business organizations such as Chamber of Commerce
- Civic leagues and associations
- Political organizations and candidates
- Social clubs
- Foreign organizations
- Homeowners' associations

# **Non-Deductible Contributions**

- Cost of raffle, bingo, or lottery tickets
- Tuition
- Value of person's time or service
- Donated blood
- Direct contributions to an individual
- Part of contribution that benefits taxpayer

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### **Miscellaneous Deductions**

Pub 17 Ch 26

- Subject to 2% of AGI threshold
  - Line 21 Unreimbursed employee expenses
    - \* Uniforms, job hunting, union dues, etc.
    - \* Use 2106-EZ for mileage and travel
  - Line 22 Tax preparation fees

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# **Miscellaneous Deductions (cont.)**

- Subject to 2% of AGI threshold (cont)
  - Line 23 Other expenses, examples
    - Investment fees
    - \* Safe deposit box (if holds investments)
    - \* IRA trustee fee (if paid from outside funds)

Miscellaneous Not Subject to 2%

- Gambling losses to extent of winnings
- Unrecovered investment in annuity
- Certain work-related expenses for disabled
- Certain casualty losses

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# Alternating (Bunching) Deductions

- One year file Itemized
  - Paying two years of property taxes
  - Paying two years of contributions
  - Or high medical expenses
- Next year file standard
  - Paying no property taxes
  - Paying minimal contributions & medical

# **Other Taxes**

- Self-employment tax
- Social security and Medicare taxes on tip income
- Additional taxes on IRAs and other qualified retirement plans
- Repayment of first-time homebuyer credit
- SRP for health insurance

# Additional Tax on IRAs, etc. Form 5329

- Distributions before 59½ not rolled-over ("early distribution") (Pt I) – 10% additional tax
- Required Minimum Distribution (RMD) not taken after 70½ (Pt IX) – 50% additional tax
- >There are exceptions

01

# **Types of Payments**

1040 page 2

- Federal income tax withheld
- Estimated payments
- Amounts applied from prior year
- Earned income credit
- Additional child tax credit (Form 8812)
- American opportunity credit (Form 8863)
- Premium tax credit (Form 8962)
- Payments made with request for extension
- Excess social security or tier 1 RRTA tax withheld

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# **Estimated Payments**

- Typically made if:
  - Self-employed
  - Investment income
  - Projected balance due >\$1,000 (to avoid penalty)
- Payments made periodically by taxpayer

# **Refund Options**

- Receive refund by check no action needed
- Direct Deposit
  - One account -OR-
  - Add Form 8888 for split refund
    - \* Up to three different accounts
    - Can receive a portion in a check
    - \* Can purchase US Series I Savings Bond
- · Apply some or all to next year's tax

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# **Direct Deposits**

- Use Direct Deposit
  - Faster (1-2 weeks versus 3+ weeks by mail)
  - Safer
- For checking account, get routing number and account number from bottom of check

# **Direct Deposits**

- IRS will send refund to savings account, but its routing transit number is often not easy to locate
- Direct deposit of refund may only go to account (or accounts) in taxpayer's name
- Financial institutions may not allow joint refund to be deposited into an individual account

# **Payment Due Options**

- Due by April 15 (or later if extended due to weekends or holidays; 2018–April 18)
  - 1. Check or money order mailed with Form 1040-V, Payment Voucher
  - 2. Electronic funds transfer (ACH)
  - 3. IRS Direct Pay
  - 4. Credit card (may have additional fee)

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# **Line 77 Estimated Tax Penalty**

- If tax owed is \$1,000 or more AND
- Withholding and estimated payments less than the smaller of:
  - 90% of tax shown on current tax return OR
  - 100% of tax shown on 2015 tax return
- > Possible penalty may be due

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# **Record Keeping**

- Basic record keeping requirements
  - Taxpayer should keep copy of all records used to file tax return
    - \*Three years from date return was filed
    - \*Two years from date tax was paid
  - See Pub 17 for additional requirements

# **Tax Return Preparation**

- Verify and clarify information which appears to have changed from last year's tax return
- Verify you have all needed documents by comparing to last year's documents
- Verify accuracy of documents and receipts (e.g. correct year)

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# **Quality Review Your Return**

- Look for typos, transposed digits, missing information, misspellings, etc.
- If not using tax software, check your math
- Does the return look similar to last year and does it have similar results?
- Did you do anything new this year that you didn't include?

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# **Quality Review Your Return**

- Verify adjustments
- Verify deductions (Schedule A)
- Verify credits including required forms
- Verify correct entry of withholding and any estimated payments
- Verify direct deposit information
  - Bank routing number and account number

# **AARP Foundation Tax-Aide**

- Nationwide non-profit program administered by AARP Foundation
- Helps low-to-moderate income taxpayers with special attention to age 60+
- Free confidential service
- Committed to high-quality service
- Answers tax questions/prepares returns
- Funding from AARP Foundation and IRS

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# **Next Year's Taxes**

- Medical deduction > 7.5% (10% in 2019)
- Increased standard deduction
- Eliminates personal exemptions
  - These two changes combined may be good or bad
- Changed tax brackets, lowered %s
- Child Tax Credit increased from \$1,000 to \$2,000 (\$1400 refundable)

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# **Next Year's Taxes (continued)**

- Added \$500 non-ref for other dependents
- Alimony has no tax affect for divorces > 2018
- SRP reduced to zero after 2018
- 529 educ plans for primary, secondary or >
- Lower debt limit for new home mortgage ded
- Repealed deduction for home equity loans
- State/local tax deduction limited to \$10,000

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# **Introduction to Income Tax**

Questions...



Comments...

