Spring 2019

INCOME TAX!

Michael J. Bootsma, JD, CPA

Stoney Creek Hotel & Conference Center
Johnston, Iowa

TAX CUTS AND JOBS ACT

- Eliminated personal exemptions and increased taxpayer's standard deduction
  - For example, the previous standard deduction for a single taxpayer was $6,500; the new standard deduction jumped to $12,000 in 2018
  - For a family, the new standard deduction increased to $24,000
- The child tax credit is increasing from $1,000 to $2,000 per qualifying child (under the age of 17) to help offset the loss of the personal and dependency exemptions.
  - An additional $500 credit is available for qualifying dependents who don't qualify the taxpayer for the child tax credit.
  - As an example, a child who is 18 or older who won't qualify for the child tax credit but is still considered a dependent.

TAX CUTS AND JOBS ACT

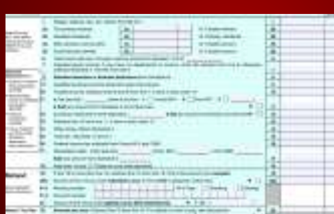
- Itemized deductions will be limited to $10,000 in total for state income and real estate taxes, combined.
- The itemized deduction for home equity loan interest has been eliminated. However, interest from a loan used to purchase a home still is deductible with some new limitations.
- **Other eliminated deductions**
  - Alimony payments from a divorce decree signed or amended after Dec. 31, 2018
  - Moving expenses for most taxpayers
  - Tuition and fees for higher education expenses

TAX CUTS AND JOBS ACT

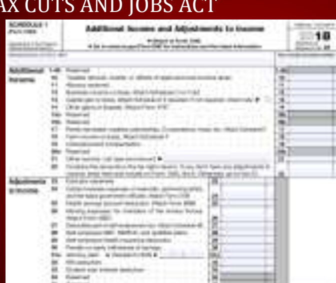
- Simpler form and lower rates

TAX CUTS AND JOBS ACT

- Simpler form and lower rates



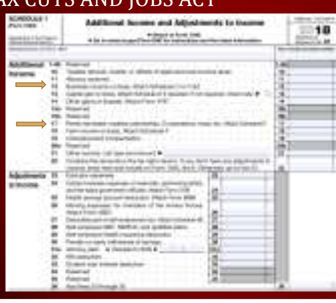
TAX CUTS AND JOBS ACT



TAX CUTS AND JOBS ACT

- Qualified Business Income Deduction
  - Deduction of 20 percent of QBI from a domestic business operated as a sole proprietorship or through a partnership, S corporation, trust or estate.
  - Limitations:
    - Taxable income
    - Amount of W-2 wages paid
    - Unadjusted basis of qualified property

TAX CUTS AND JOBS ACT


SCHEDULE 1
Additional Income and Adjustments to Income
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S CORPORATIONS

- S corporations are separate legal entities and file form 1120S
  - Partners receive a K-1 reporting their share of income and loss items
- Income
  - Interest and dividends go to their respective lines on the form 1040
  - Shareholders who work for the S corp report wage income on line 7
  - Ordinary income (everything else that is taxable) should go on line 17 of the form 1040 via schedule E
- Distributions should not be taxable because they are generally distributions of previously taxed income. Exceptions (rare):
  - C corporations that later become S corporations
  - Unprofitable S corporations that borrow money and then give it out as a distribution
  - Page 3 Line 16d of S corp return. Same line item on K-1.

S CORPS

- Peter and Charlie form the PC - S Corporation. Each is a 50% owner.
- Year 1, the S corporation suffers a loss of $10,000. Peter and Charlie may or may not report the amount of -$5,000 on line 17 of their individual income tax form 1040 because of loss limitation rules
- Year 2, the S corporation creates taxable income of $10,000. Whether or not Charlie and Peter report $5,000 of income on line 17 of the form depends on whether or not they reported the loss in year 1.
- Year 3, the S corporation creates taxable income of $30,00 and Peter should each report $15,000 of income on line 17 or may not receive any cash distributions.

1120-S

K-1

PARTNERSHIPS (OR MULTIPLE MEMBER LLC'S)

- Business Entity files Form 1065
- Partners receive a K-1 (like an S corporation)
- Partnership is a tax flow through entity like an S corporation
  - However, partners cannot be paid a salary but S corporation owners can
  - Income
    - Interest and dividends go to their respective lines on the form 1040
    - Ordinary income (everything else that is taxable) should go on line 17 of the form 1040 via schedule E

PARTNERSHIP FORM 1065

FORM K-1

SOLE PROPRIETORSHIP

- Non incorporated business entity or a single member LLC
- Owner reports income on schedule C
  - Owner is not paid a salary (or wages) for tax purposes
  - Owner may get a form 1099 MISC from customers (but not always)

SCHEDULE C

CAPITAL GAINS AND LOSSES

- Generated by capital gain assets and reported on line 13 of the form 1040 via schedule D/schedule 1
- Common examples:
  - Sale of stock held for any period of time
  - Mutual fund pass through
  - Partnership or 1120S pass through
  - Land held for investments held for any period of time
  - Sale of business property owned longer than 1 year

MEDICAL EXPENSES

MEDICAL EXPENSES

- Generally only deductible if the amount exceeds 10% of AGI (7.5% for 2018) AND the taxpayer itemizes deductions on schedule A
  - May not be reported because
    - Taxpayer does not itemize and/or
    - Taxpayer did not have enough to deduct
- Mike Bling has AGI of $65,000 (found on bottom of page 1 of form 1040
  - His medical expenses would have to exceed $6,500 before he can deduct any of his medical expenses. In addition, if this is his only itemized deduction, he might not itemize at all.

SOCIAL SECURITY BENEFITS

- Generally not taxable unless person has significant income from other sources
  - No one pays federal income tax on more than 85 percent of his or her Social Security benefits based on federal income tax rules.
    - Mike Bling has $150,000 in net rental income. He also receives $10,000 in Social Security benefits. He may pay income tax at his marginal rate (assume 28%) on 85% of his Social Security benefit. $10,000 * .85 = $8,500. This income would show on page 1 of the 1040. $10,000 would be reported on line 20a of the 1040 and $8,500 is would be reported on line 20b.
- Reported on form SSA 1099

SOCIAL SECURITY BENEFIT CALCULATION

Taxpayer’s adjusted gross income from form 1040
+ Nontaxable interest
+ <u>½ of your Social Security benefits</u>
= Taxpayer’s " ***combined income*** “

We use combined income to determine whether or not any portion of your Social Security benefit is taxable

AMOUNT TAXABLE

- **If Single Filing Status -** and taxpayer’s *combined income* ***(from previous slide)*** is
  - between $25,000 and $34,000, taxpayer may have to pay income tax on up to 50 percent of taxpayer’s benefits.
  - more than $34,000, up to 85 percent of taxpayers benefits may be taxable.
- **If Married Filing Jointly**, and spouses have a *combined income* that is
  - between $32,000 and $44,000, taxpayers may have to pay income tax on up to 50 percent of their benefits
  - more than $44,000, up to 85 percent of their benefits may be taxab
- **If Married Filing Separately**, taxpayer probably will pay t on benefits.

SCHOLARSHIPS AND GRANTS

- **Tax-Free If**
- 1) Candidate pursuing degree at a qualified educational institution
- 2) Amount was used to pay for tuition, fees, books or even supplies and equipment if supplies and equipment are required

TAXABLE

- "You must include in gross income:
  - Amounts used for incidental expenses, such as room and board, travel, and optional equipment.
  - Amounts received as payments for teaching, research, or other services required as a condition for receiving the scholarship or fellowship grant. However, you don't need to include in gross income any amounts you receive for services that are required by the National Health Service Corps Scholarship Program, the Armed Forces Health Professions Scholarship and Financial Assistance Program, or a comprehensive student work-learning-service program (as defined in section 448(e) of the Higher Education Act of 1965) operated by a work college."
  - https://www.irs.gov/taxtopics/tc421

PELL GRANTS

- Pell Grants (and many other scholarships) can be treated in one of two ways for tax purposes:
- 1. Tax-free and subtracted from AOTC-eligible expenses. Pell Grants allocated to QTRE are excluded from taxable income, but they are also subtracted from QTRE for purposes of the AOTC and LLC, potentially reducing the credit for which students are eligible.
- 2. Taxable and not subtracted from AOTC-eligible expenses. Pell Grants allocated to living expenses such as room and board are included in the student's taxable income and are not subtracted from QTRE for purposes of the AOTC and LLC, potentially increasing the credit for which students are eligible. Current law generally allows students to decide whether to treat their Pell Grants as paying for QTRE or for living expenses.
  - https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Pell-AOTC-Interaction-2014.pdf

PAYSTUBS AND W-2

Pay Stub **Medeling Engineering**
31-Dec-18

Employee	**Mike Bling**	
	Current	**YTD**
Gross Wage	5000.00	50,500
FWH	(545.00)	(6,540)
SS	(310.00)	(3,720)
Medicare	(82.50)	(990)
SWH	(242.00)	(2,904)
Net Pay	3,820.50	36,346

W-2

Form W-2	a. Employee's Social Security Number 489-58-3636	For Official Use Only OMB	
b. Employer's Identification Number (EIN) 42-6554898		1. Wages, tips, other compensation 48,500.00	2. Federal Income Tax Withheld 6,473.75
c. Employer's name, address and zip code Medeling Engineering 4861 Stoney Brook Drive Ames, Iowa 50010		3. Social Security Wages 50,500.00	4. Social Security Tax Withheld 3,156.25
		5. Medicare Wages 50,500.00	6. Medicare Tax Withheld 732.25
		7. Social Security Tips	8. Allocated Tips
d. Control Number 56894221		9.	10. Dependent Care Benefits
e. Employee's First Name Mike	Last Name Bling / Suffix	11. Nonqualified Plans	12a See Instructions for Box 12
826 Frederickson Court Apt 88, Ames, Iowa 50011 f. Employee's address and zip code		13	12b
		14. Other	12c
			12d

15. State	Employer's State ID Number	16. State Wages	17. State Income Tax	18. Local Wages, tips ect	19. Local Income Tax	20. Locality Na
IA	42-6554898001	48,500.00	2,910.00			

REASONS WHY BOXES 1, 3, AND 5 DON'T MATCH

- Corporate sponsored health insurance
- Corporate sponsored life insurance
- Tax-free fringe benefits
- Retirement plan contributions
- Taxpayer reached social security taxable limit

TAX TRANSCRIPTS

- https://www.irs.gov/individuals/get-transcript

TRANSCRIPT

FILING STATUS

- Single
- Married filing jointly
  - Need to married by year-end
  - Can still be MFJ in year spouse dies
- Married filing separately
  - Rare for federal
  - Couple can file separately on Iowa return when filing federal return jointly
- Head of household
- Qualifying widow(er) (requires qualifying child)

HEAD OF HOUSEHOLD

a. Unmarried –
   - or "considered unmarried"

b. Maintain home –
   - paid more than half the cost of keeping up a home for the year.

c. Dependent relative –
   - "qualifying person" lived in the home of the taxpayer for more than half the year.

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QUALIFYING RELATIVE

- Your child, stepchild, foster child, or a descendant of any of them (for example, your grandchild). (A legally adopted child is considered your child.)
- Your brother, sister, half brother, half sister, stepbrother, or stepsister.
- Your father, mother, grandparent, or other direct ancestor, but not foster parent.
- Your stepfather or stepmother.
- A son or daughter of your brother or sister.
- A son or daughter of your half brother or half sister.
- A brother or sister of your father or mother.
- Your son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sis

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TWO RELATIONSHIP TESTS FOR HOH

- If not "divorced"
  - Need child, stepchild, or foster child to live with taxpayer for more than ½ of the year
- Need dependent relative to live with the taxpayer for more than ½ of the year
  - Divorced or separated
  - Exception for parents

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ADIOS!

- mbootsma@iastate.edu