Schwartz & Schwartz, P.C.

CPAs Specializing in Healthcare Professionals

How the New Tax Law May Impact Taxpayers with High Incomes, Dependents, or Complex Returns

The Tax Cuts and Jobs Act, the tax reform legislation passed last December, made major changes to the tax law, including increasing the standard deduction, removing personal exemptions, increasing the Child Tax Credit, limiting or discontinuing certain deductions and changing tax rates and tax brackets. Any of these far-reaching changes could have a big impact on the tax refund or balance due on your tax return next year.

Changes that affect high-income taxpayers:

For 2018, the standard deduction nearly doubled to $24,000 for joint filers and $12,000 for singles. There were also numerous changes to itemized deductions, including:

- A $10,000 cap on deductions for state and local property, sales and income taxes.
- Reduced limits on deductions for some mortgage interest and home equity debt.
- Higher limits on the percent of income a taxpayer can deduct as charitable contributions.
- No deduction for those miscellaneous expenses that, in prior tax years, had to exceed 2 percent of a filer's income to qualify. These included investment expenses and un-reimbursed employee expenses such as travel, meals, entertainment and uniforms.

Many who itemized in the past may find they'll pay less tax in 2018 by taking the standard deduction.

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IRS Introduces New Tax Transcript to Better Protect Taxpayer Data

The IRS has recently launched a new format for individual tax transcripts to protect taxpayer data from unauthorized disclosure and theft.

The new format will redact personally identifiable information from the Form 1040 series. Financial entries will remain visible, which will give taxpayers and third-parties the data they need for tax preparation and income verification.

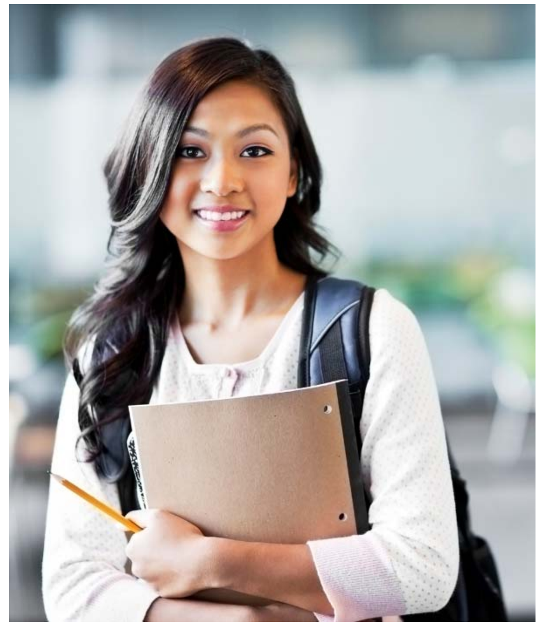
As of September 23, the new transcripts became the default format available through the IRS's "Get Transcripts Online" and "Get Transcripts by Mail" program.

Additionally, the IRS also has created a new Customer File Number that lenders, colleges and other third parties that order transcripts for non-tax purposes can use as an identifying number instead of the taxpayer's SSN. The Customer File Number can be created by the taxpayer or third party and will be visible on the requested tax transcript, allowing the third party to match the document to the taxpayer. A Customer File Number can be, for example, a loan account number and can't be the taxpayer's social security number.

There is no change in the process for students seeking income verification through Free Application for Federal Student Aid (FAFSA) or disaster victims seeking FEMA assistance. Business tax transcripts will not change as well.

Please visit the IRS website's to read "About the New Tax Transcript: FAQs" for additional details and see a sample of the new transcript format.

Are Scholarships and Fellowships Taxable?



We recently received an interesting question from a client that we know many of you may have as well:

> *"My daughter-in-law is doing a PhD and has an NSF Fellowship from the government. Interestingly, the government does not take out taxes nor provide a W2 or 1099 form. I presume that the income is taxable but the government site says "it **may** be taxable income". Are there any situations when this income would not be taxable?"*

It's our understanding that this income is subject to federal and state income taxes, but is not subject to Social Security or Medicare taxes. A lot of people receiving these grants don't think the income is taxable since no tax form is provided. Grants and scholarships are taxable to the extent that the money received exceeds tuition paid. Here are the rules from the IRS:

Scholarships and Fellowships

A scholarship is generally an amount paid or allowed to, or for the benefit of, a student at an educational institution to aid in the pursuit of studies. The student may be either an undergraduate or a graduate. A fellowship is generally an amount paid for the benefit of an individual to aid in the pursuit of study or research. Generally, whether the amount is tax free or taxable depends on the expense paid with the amount and whether you are a degree candidate.

A scholarship or fellowship is tax free only if you meet the following conditions:

- You are a candidate for a degree at an eligible educational institution.
- You use the scholarship or fellowship to pay qualified education expenses.

Qualified Education Expenses

For purposes of tax-free scholarships and fellowships, these are expenses for:

- Tuition and fees required to enroll at or attend an eligible educational institution.
- Course-related expenses, such as fees, books, supplies, and equipment that are required for the courses at the eligible educational institution. These items must be required of all students in your course of instruction.

However, in order for these to be qualified education expenses, the terms of the scholarship or fellowship cannot require that it be used for other purposes, such as room and board, or specify that it cannot be used for tuition or course-related expenses.

Expenses that Don't Qualify

Qualified education expenses do not include the cost of:

- Room and board
- Travel
- Research
- Clerical help
- Equipment and other expenses that are not required for enrollment in or attendance at an eligible educational institution

This is true even if the fee must be paid to the institution as a condition of enrollment or attendance. Scholarship or fellowship amounts used to pay these costs are taxable.

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Changes that could affect the withholding of parents and caretakers:

Child tax credit

- The maximum child tax credit doubled from $1,000 to $2,000 per qualifying child.
- Taxpayers whose income was too high to benefit from the Child Tax Credit in prior years may now find they qualify.
- The credit now phases out at $400,000 for couples and $200,000 for singles, compared with 2017 amounts of $110,000 for couples and $75,000 for singles.

Additional child tax credit

- The maximum additional child tax credit increased from $1,000 to $1,400.
- The ACTC is a refundable credit for taxpayers who owe little or no federal income tax.

Credit for other dependents

- There's a new $500 credit that can benefit taxpayers who support other dependents.
- The taxpayer will claim the credit when filing a tax return.
- For purposes of this new credit, other dependents count including qualifying children or qualifying relatives, such as a college student or an elderly parent.

Personal exemption

- The new law removes the personal exemption that taxpayers formerly claimed for themself, their spouse and dependents.

Contact Your Preparer to do a 'Paycheck Checkup'

Checking and adjusting how much tax is withheld from your pay now can prevent an unexpected tax bill and penalties next year at tax time. It can also help you avoid a large tax refund, if you'd prefer to have your money in your paychecks throughout the year.

Please contact your tax preparer for help with adjusting your withholdings or to answer any questions about the tax changes.

ARE YOU PREPARED FOR A DISASTER?

A natural disaster can strike at any time. Take time now to:

- **Document valuables – including by photographing or videotaping the contents of your home.**
- **Review and update your emergency plans annually. Visit Ready.Gov for help with planning.**
- **Create electronic copies of key documents such as bank statements, tax returns, identification documents and insurance policies.**
- **Watch the free webinar from the IRS "Staying Afloat: Planning for Emergencies Before They Happen" on their website at www.irs.gov.**
- **Visit the National Weather Service website for hurricane preparedness and storm tips at www.weather.gov.**

The New Section 199A Qualified Business Income Deductions

What is qualified business income deduction?

Section 199A qualified business income deduction is available from 2018 to 2025. Taxpayers may deduct 20% of Qualified Business Income from Partnerships, S Corporations, Sole Proprietorships (Schedule C's) and Real Estate Rental Activities (Schedule E's). This deduction was enacted to help pass-through entities who didn't receive the benefit of 21% C-corporation tax rate.

A sole proprietor with net Schedule C income of $100k can now take a tax deduction of $20k on his or her personal tax return, subject to income limitations discussed below.

Calculation of Section 199A deduction

The deduction is a function of the taxpayer's taxable income, net business income, and the wages paid and/or property owned by the business, and is generally based on the following:

- 20% of taxpayer's qualified business income.
- The greater of 50% of the business's W-2 wages or 25% of the business's W-2 wages plus 2.5% of the original cost of all qualified property.

Ask Your Tax Preparer If You Qualify for this New Deduction

Full QBI deduction for Single taxpayers with taxable income below $157,500 and Married Couples with joint income below $315,000

For the single taxpayer with total taxable income below $157,500 ($315,000 for married filing jointly), the W-2 wages limit does not apply. Instead, the deduction will be limited to the lesser of 20% of the qualified business income or 20% of the total taxable income. It does not matter what kind of trade or business the taxpayer has.

Fully phased-out QBI deduction for Single taxpayer with taxable income exceeding $207,500 and Married Couples with joint income in excess of $415,000

Once the single taxpayer's taxable income exceeds $207,500 ($415,000 for MFJ), taxpayer's section 199A deduction is limited to the lesser of 20% of taxpayer's qualified business income or the greater of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of depreciable property.

<u>But a "specified service business" is no longer eligible for this deduction.</u>

A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities.

Partially phased-out QBI deduction for Single taxpayer with taxable income between $157,500 to $207,500 and Married Couples with joint income between $315k to $415k

When a single taxpayer's taxable income exceeds $157,500 ($315,000 for MFJ), the W-2 limitation is phased in. The deduction is limited to the lesser of 20% of taxpayer's qualified business income or the greater of 50% of W-2 wages or 25% of W-2 wages plus 2.5% of depreciable property. The qualified business income should be adjusted by an exclusion amount.

For example: An individual has taxable income of $177,500, QBI of $100,000. Base is $157,500. Top range is $207,500. The difference is $50,000. Amount over base is $20,000. Percentage that should be excluded from QBI: $20,000/$50,000=40%. So, the exclusion amount is $40,000. Adjusted QBI is $60,000. Deduction is $30,000 ($60k*20%).