



WINTER 2018

## Dear Client:

As we wind down another year, we extend our wishes for a wonderful holiday season and a prosperous and joyous new year.

The many changes we have been sharing with you are being finalized by Congress and the Internal Revenue Service and incorporated into the tax software for the upcoming tax filing season. This includes the new tax law signed in December of 2017 (Tax Cuts and Jobs Act) and the new Form 1040, U.S. *Individual Income Tax Return*, for the 2018 tax returns. There has been no date yet announced when we will be able to file 2018 taxes in January 2019.

Just a reminder that by legislation, refunds from tax returns which include the earned income tax credit or the child tax credit will again be delayed until after February 15, 2019. We can begin processing returns as soon as tax season opens and our office will be open to begin tax

preparation services when you have compiled your documents.

In this issue we are addressing the topic of “What is Income?” The IRS has identified various sources of ‘nontraditional’ gross income such as GoFundMe, Kickstarter, Airbnb or virtual currency. However, what is taxable and not taxable is a matter of facts and circumstances.

There are new rules for taxpayers filing as Head of Household which will require documentation supporting this filing status. All tax professionals have an obligation to confirm a client’s claim for various credits such as: earned income tax credit, child tax credit or the other dependent credit, and the American Opportunity Tax Credit. We may be requesting that you bring in school or medical records to substantiate residency of dependent children. If you are the noncustodial parent and it is your year to claim the dependency for your child it is

required that the Form 8332, *Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent*, be on file in our office and submitted with the filing of the tax return.

We are committed to providing you with accurately prepared returns in a timely manner. By completing the organizer, bringing in all your documents, and providing the documentation needed to support your eligibility for the various credits we can both be assured that you are receiving the best tax preparation services.

If you have any questions regarding tax issues, please contact our office. Many tax strategies must be completed by December 31 in order to be available for your current year tax planning.

## Last-Minute Year-End 2018 Tax-Saving Moves for Individuals

Although there are only several weeks left to go before the year ends, it’s not too late to implement some planning moves that can improve your tax situation for 2018 and beyond.

**Make HSA contributions.** A taxpayer who is an eligible individual under the health savings account (HSA) rules for December

2018 is treated as having been an eligible individual for the entire year. Thus, an individual who first became eligible on, for example, December 1, 2018, may then make a full year’s deductible-above-the-line contribution for 2018. If the individual makes that maximum contribution, you can get a deduction of \$3,450 for individual

coverage and \$6,900 for family coverage (those age 55 or older also get an additional \$1,000 catch-up amount).

**Nail down losses on stock while substantially preserving one’s investment position.** You may have experienced paper losses on stock in a particular company or industry in which

you want to keep as an investment. The taxpayer may be able to realize their losses on the shares for tax purposes and still retain the same, or approximately the same, investment position. This can be accomplished by selling the shares and buying other shares in the same company or another company in the same industry to replace them, or by selling the original holding then buying back the same securities at least 31 days later.

#### **Apply a bunching strategy to deductible contributions and/or payments of medical**

**expenses.** Beginning in 2018, many taxpayers who claimed itemized deductions in prior years will no longer be able to do so. That's because the standard deduction has been increased and many itemized deductions have been cut back or abolished. A bunching strategy can help taxpayers get around these new limits — by accelerating or deferring discretionary medical expenses and/or charitable contributions into the year where they will do some tax good. For example, a taxpayer who expects to itemize deductions in 2018 but not 2019, and usually contributes a total of \$1,500 to charities each year, should consider making a total of \$3,000 of charitable contributions before the end of 2018 (and skipping charitable contributions in 2019).

**Solve an underpayment of estimated tax problem.** Employees may discover that their prepayments of tax for 2018 have been too small because, for example, their estimate of income or deductions was off and they are under withheld, or they failed to make estimated tax payments for unanticipated income, such as gains from sales of stock. Or they may be facing a penalty for underpayment of estimated tax because of the additional 0.9% Medicare tax and/or the 3.8% surtax on unearned income. To ward off or reduce an estimated tax underpayment penalty, employees can ask their employers to increase withholding for their last paycheck or paychecks to make up or reduce the deficiency. Employees can file a new Form W-4 or simply request that the

employer withhold a flat amount of additional income tax.

Increasing the final estimated tax payment for 2018 (due on January 15, 2019) can cut or eliminate the penalty for a final-quarter underpayment only. But it does not help with underpayments for preceding quarters. By contrast, tax withheld on wages can wipe out or reduce underpayments for previous quarters because, as a general rule, an equal part of the total withholding during the year is treated as having been paid on each quarterly estimated payment date.

**Retirement plan distribution.** An individual can take an eligible rollover distribution from a qualified retirement plan before the end of 2018 if you are facing a penalty for underpayment of estimated tax and the increased withholding option described above is unavailable or will not sufficiently address the problem. Income tax will be withheld from the distribution at a 20% rate and will be applied toward the taxes owed for 2018. The individual can then timely roll over the gross amount of the distribution, as increased by the amount of withheld tax, to a traditional IRA. No part of the distribution will be includible in income for 2018, but the withheld tax will be applied pro rata over the full 2018 tax year to reduce previous underpayments of estimated tax.

**Be sure to take required minimum distributions (RMDs).** Taxpayers who have reached age 70½ years of age should be sure to take their 2018 RMD from their IRAs or 401(k) plans (or other employer-sponsored retired plans). Failure to take a required withdrawal can result in a penalty of 50% of the amount of the RMD not withdrawn. Those who turned age 70½ in 2018 can delay the first required distribution to 2019. However, taxpayers who take the deferral route will have to take a double distribution in 2019 — the amount required for 2018 plus the amount required for 2019. This strategy could make sense if the taxpayer will be subject to a lower tax rate next year.

**Use IRAs to make charitable gifts.**

Taxpayers who have reached age 70½, own IRAs, and are thinking of making a charitable gift should consider arranging for the gift to be made by way of a qualified charitable contribution, or QCD—a direct transfer from the IRA trustee to the charitable organization. Such a transfer (not to exceed \$100,000) will neither be included in gross income nor allowed as a deduction on the taxpayer's return. But, since such a distribution is not includible in gross income, it will not increase AGI for purposes of the phaseout of any deduction, exclusion, or tax credit that is limited or lost completely when AGI reaches certain specified level.

A qualified charitable contribution before year end is a particularly good idea for retired taxpayers who do not need all of their as-yet undistributed RMD for living expenses. That's because a charitable contribution distribution reduces the amount of the RMD that must be withdrawn, resulting in tax savings.



**Wrap up a divorce.** Alimony payments made under a divorce or separation agreement that is executed before January 1, 2019, are deductible by the payor and included in the income of the payee. But if made under a divorce or separation agreement executed after December 31, 2018, the payor can no longer deduct the alimony payments and the payee doesn't include them in income. Where the payor of alimony is in a higher marginal income tax bracket than the payee, it is beneficial, for the divorcing

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spouses as a whole, for the alimony to be deductible to the payor and taxable to the payee. And, that benefit can be split between the two spouses by having the payor pay more alimony than the payor otherwise would pay if the alimony were not deductible to the payor. Thus, in most cases, couples in the midst of a divorce involving alimony payments should finalize that agreement by December 31, 2018.

**Make year-end gifts.** A person can give any other person up to \$15,000 for 2018 without incurring any gift tax. The annual exclusion amount increases to \$30,000 per donee if the donor's spouse consents to gift-splitting. Anyone who expects eventually to have estate tax liability and who can afford to make gifts to family members should do so. Besides avoiding transfer tax, annual exclusion gifts take future appreciation in the value of the gift property out of the donor's estate, and shift the income tax obligation on the property's earnings to the donee who may be in a lower tax bracket (if not subject to

the kiddie tax).

A gift by check to a noncharitable donee is considered to be a completed gift for gift and estate tax purposes on the earlier of:

1. The date on which the donor has so parted with dominion and control under local law so as to leave the donor with no power to change its disposition, or
2. The date on which the donee deposits the check (or cashes it against available funds of the donee) or presents the check for payment, if it is established that:
  - The check was paid by the drawee bank when first presented to the drawee bank for payment;
  - The donor intended to make a gift;
  - The donor was alive when the check was paid by the drawee

bank;

- Delivery of the check by the donor was unconditional; and
- The check was deposited, cashed, or presented in the calendar year for which completed gift treatment is sought and within a reasonable time of issuance.

Thus, for example, a \$15,000 gift check given to and deposited by a grandson on December 31, 2018 is treated as a completed gift for 2018 even though the check doesn't clear until 2019 (assuming the donor is still alive when the check is paid by the drawee bank).

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***Be sure to contact our office or your financial planner in order to take advantage of these tax strategies.***

## Substantiation Required for Charitable Donations

As a reminder following are the IRS rules for substantiating charitable donations. We encourage you to maintain the records necessary to support your claim for these donations in the event of an audit. Many taxpayers may not be able to deduct their charitable donations due to the increased standard deductions (\$12,000 for singles/ \$24,000 for joint returns). However, if your itemized donations do exceed the standard deductions be prepared to provide adequate documentation.

Cash contributions: No charitable contribution deduction is allowed for any monetary gift unless the donor maintains, as a record of the gift, a bank record or a written communication from the donee,

showing the donee's name, the date of the contribution, and the amount of the contribution. The regulations require a contemporaneous written acknowledgment of contributions of \$250 or more from the organization. For gifts under \$250, a canceled check or other records by the taxpayer is sufficient.

Donations of property: Additional substantiation requirements apply when donations involve property. For property under \$250, the donor must obtain a receipt from the donee or keep reliable records. A donor who claims a noncash contribution of at least \$250 but not more than \$500 is required to obtain a contemporaneous written acknowledgment. For a donation of

more than \$500 but not more than \$5,000, the donor must obtain a contemporaneous written acknowledgment and file a completed Form 8283 (Section A), *Noncash Charitable Contributions*.

For claimed noncash contributions of \$5,000 or more, in addition to a contemporaneous written acknowledgment, the donor must obtain and file a qualified appraisal with the filing of the tax return.

If you are uncertain if your documentation is adequate, contact our office for guidance on what is needed to include the donations on your 2018 tax return.

## Planning For Your Child's Financial Future

One of the future goals for your children is their financial security and assistance with education goals. It is important to demonstrate the value of saving money and taking advantage of tax breaks. The Tax Cuts and Jobs Act (TCJA) includes provisions that affect tax planning for children and their education.

### **“Kiddie Tax”**

The “kiddie tax” generally applies to unearned income of children under the age of 19 or under age 24 for a full-time student. Before 2018, unearned income was generally taxed at the parents’ tax rate

Under the TCJA the kiddie tax will now be taxed according to the tax brackets which are used for estate and trusts. The tax return of your children will no longer be dependent on the parents return or the returns of siblings who are also subject to the kiddie tax.

### **IRAs for Teens**

IRAs can be perfect for teenagers because they likely will have many years to let their accounts grown tax-deferred or tax-free.

Choosing a Roth IRA typically provides a better tax advantage for your teenager. Now that the standard deduction is \$12,000 for single taxpayers (even if they are dependents on their parents return) it is most likely that the traditional IRA would not provide a pre-tax benefit. Your child can have income up to \$12,000 without a tax filing requirement but they now have income to fund a Roth IRA (which is post-tax) which grows tax-deferred and can be distributed tax-free.

### **529 Plans**

Section 529 plans provide valuable tax-advantage savings opportunities for your students. Although the contributions are not tax deductible for federal purposes, any growth is tax-deferred. If used for qualified education expenses the funds are distributed tax free. Under the TCJA, 529 plans can now be used for K-12 tuition and fees up to \$10,000 per year.

A special tax advantage for the 529 plans is to allow you to front-load five years’ worth of annual gift tax exclusions and make up to a \$75,000 contribution.

### **Coverdell Education Savings Accounts**

Like the 529 plans the contributions are not tax deductible for federal purposes, but plan assets grow tax-deferred and distributions used to pay qualified education expenses are tax free.

Coverdell’s can be used for K-12 expenses for tuition and fees as well as other qualified expenses such as uniforms, transportation, program fees, computers and internet costs.

Unlike the 529 plans, however, the ability to contribute to a Coverdell plan are subject to income limitations. The phase-out for single taxpayers starts at \$95,000 and \$190,000 for joint returns.

### **ABLE Accounts**

Achieving a Better Life Experience (ABLE) accounts offer a tax-advantaged way to fund qualified disability expenses for a beneficiary who became disabled or blind before age 26. Under the TCJA 529

education plan funds can be rolled over to an ABLE account without penalty. The ABLE account must be owned by the beneficiary of the 529 plan or by a member of their family. The rolled-over amounts count toward the overall ABLE account annual contribution limit which is \$15,000 for 2018.

### **American Opportunity Credit**

The maximum credit, per student, is \$2,500 per year for the first four years of postsecondary education. Both the AOTC and a distribution from either a 529 plan or Coverdell can be taken in the same year as long as the expenses are not the same.

The AOTC does have income threshold limitations; the phase-out range for single taxpayers is \$80,000 to \$90,000 and the phase-out range for joint files is \$160,000 to \$180,000.

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***Contact our office if you have any questions regarding these tax-deferred or tax free programs to help your student with meeting their higher education goal***



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## ***What Income is to be Reported on My Tax***

## Return?

There are many sources of income that must be included on your individual income tax return such as wages, interest, dividends, self-employment, rental income, pensions, IRA's, etc. Some of the non-traditional income sources that the IRS is targeting includes income from: Lyft or Uber drivers, home rentals through Airbnb or VRBO, GoFundMe or Kickstarter campaigns, and virtual currency (or cryptocurrency) such as Bitcoin.

### **Independent Driver**

As a driver for Uber or Lyft you are considered an independent contractor and all income derived is reported on Schedule C, *Profit or Loss From Business (Sole Proprietorship)*.

Drivers are described as self-employed "partners" and are subject to the Form 1099 tax rules. This includes a combination of the Form 1099-K, *Payment Card and Third Party Network Transactions* for payments processed through credit cards and Form 1099-MISC, *Miscellaneous Income*, for other payments received such as referral fees, bonuses, etc.

As an independent contractor you are considered self-employed responsible for your own taxes with no benefits such as health insurance or vacations. You pay your own Social Security and Medicare Taxes (aka FICA taxes) on the net profit earned from your ridesharing business.

If your net earnings (gross income less associated business expenses) are greater than \$400 you are required to file a tax return and report your self-employment activities.

Eligible expenses may include the

following:

- car expenses (either mileage or actual expenses),
- cell phone,
- water, candies, gum or other items provided for your passengers,
- extra insurance required for your business,
- fees and commissions paid,
- parking and tolls,
- Paypal and/or other credit card transaction fees, and
- home office if have an area used exclusively and regularly for your business activities.

### **Home Rental Income**

If you rent out your home for short-term rentals (less than 14 days per year) the income is not taxable regardless of how much you earn. Your rental income is tax free if you rent out your home for 14 days or less, and the home is used personally for more than 14 days, or more than 10% of the total days it is rented out to others at a fair market rental price.

If you rent out your home for more than 14 days then you are subject to tax on income that exceeds your expenses. The rental income and expenses are report on Schedule E, *Supplemental Income and Loss (From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)* for each property that you list on the rental sites.

You can deduct 100% of any direct rental expenses, and a portion of the general or shared expenses. These

are allocated based on the amount of time the property serves as a rental, compared to the total time it is used during the year for both personal and rental use.

*EXAMPLE:* Timothy lives in his Coronado condo for 300 days during the year and rents it out for 65 days. The property was used as a rental 18% of the time ( $65/365 = 18\%$ ). Paul can therefore deduct 18% of his general expenses up to the amount of the rental income earned during the year.

In some cases, renting out all or part of your house or apartment can be classified as the equivalent of running a bed and breakfast for tax purposes. If you dedicate a room or rooms for the use of paying customers and provide substantial services such as regular cleaning, changing linen or daily maid service. In this situation your rental activity would be considered a business for tax purposes and reported on *Schedule C, Profit or Loss from Business*.

### **Crowdfunding**

The treatment of funds that are received through sources such as GoFundMe or Kickstarter are determined on a case-by-case basis. Generally, funds received through a GoFundMe account are considered a gift and as such not a tax deduction for the person making the payment and not income for the person receiving it. Those payments are generally defined as made out of a detached generosity with no expectation of "quid pro quo."

Funds received through a Kickstarter campaign are generally includable in income unless they are classified as a loan that must be repaid or a

capital contribution to an entity in exchange for an equity interest.

### ***Virtual Currency***

Virtual currency, the most popularly known is Bitcoin, are either ordinary income or a capital asset depending on the facts and circumstances.

*EXAMPLE:* Elaine's business accepts payment in Bitcoin for consulting services. When Bitcoin has a value of \$100, she charges \$500 for her services and receives 5 Bitcoin.

Several months later she purchases a \$3,000 computer system from Dell for her business when Bitcoin has a value of \$1,000 each. She uses 3 of her Bitcoins for the computer and has a short-term capital gain of \$2,700 (\$3,000 disposition price less \$300 basis). She then uses the remaining 2 Bitcoin for a vacation rental and has a short-term gain of \$1,800 (\$2,000 disposition price less \$200 basis). The Dell computer is a business asset which she can capitalize and depreciate, the vacation home is a personal expense. With this simple example Elaine has ordinary income to her business of \$500; \$4,500 of short-term capital gain; a business asset worth \$3,000 and personal expense of \$2,000.

It is important that you accurately record your virtual currency transactions. For tax purposes we need to know when the virtual currencies were purchased, the value on the date of purchase, when the currencies were traded or used, and the value on the date of disposition. In addition, if you are involved in the global market and are trading in foreign currencies we will also need to determine the value of your transactions in U.S. dollars.

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