



Newsletter

MAY 2018

Freddi & Associates Inc. would like to thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time. Also, thank you for recommending us to your family, friends, and associates. We truly appreciate your referrals.

Update on the Tax Cuts and Jobs Act (TCJA)

The Tax Cuts and Jobs Act (TCJA) was passed by Congress in a hurry late last year, and the IRS and tax preparers have been working to digest some of the more thorny issues created by the tax overhaul. Here are the latest answers to some of the most common questions:

1. Is home equity interest still deductible?

The short answer is: Not unless you've used the money to buy, build or substantially improve your home.

Before the TCJA, homeowners were able to take out a home equity loan and spend it on things other than their residence, such as to pay off credit card debt or to finance large consumer purchases. Under the old tax code, they could deduct interest on up to \$100,000 of such home equity debt.

The TCJA effectively writes the concept of home equity indebtedness out of the tax code. Now you can only deduct interest on "acquisition indebtedness," meaning a loan secured by a qualified residence that is used to buy, build or substantially improve it. If you have taken out a home equity loan before 2018 and used it for any other purpose, interest on it is no longer deductible.

2. I'm a small business owner. How do I use the new 20 percent qualified business expense deduction?

Short answer: It's complicated and you should get help.

Certain small businesses structured as sole proprietors, S corporations and partnerships can deduct up to 20 percent of their qualified business income. But that percentage can be reduced after your taxable income reaches \$157,500 (or \$315,000 as a married couple filing jointly).

The amount of the reduction depends partly on the amount of wages paid and property acquired by your business during the year. Another complicating factor is that certain service industries including health, law, consulting, athletics, financial services and accounting are treated slightly differently.

The IRS is expected to issue more clarification on how these rules are applied, such as when your business is a mix of one of those service industries and some other kind of business.

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Update on the Tax Cuts and Jobs Act (TCJA) (Cont'd)

3. What are the new rules about dependents and caregiving?

There are a few things that have changed regarding dependents and caregiving:

- **Deductions.** Standard deductions are nearly doubled to \$12,000 for single filers and \$24,000 for married joint filers. The code still says dependents can claim a standard deduction limited to the greater of \$1,050 or \$350 plus unearned income.
- **Kiddie Tax.** Unearned income of children under age 19 (or 24 for full-time students) above a threshold of \$2,100 is now taxed at a special rate for estates and trusts, rather than the parents' top tax rate.
- **Family credit.** If you have dependents who aren't children under age 17 (and thus eligible for the Child Tax Credit), you can now claim \$500 for each qualified dependent member of your household for whom you provide more than half of their financial support.
- **Medical expenses.** You can now deduct medical expenses higher than 7.5 percent of your adjusted gross income. You can claim this for medical expenses you pay for a relative even if they aren't a dependent (i.e., they live outside your household) as long as you provide more than half of their financial support.

Stay tuned for more guidance from the IRS on the new tax laws, and reach out if you'd like to set up a tax planning consultation for your 2018 tax year.

How to handle a gap in health care coverage

Health care coverage gaps happen. Whether because of job loss or an extended sabbatical between gigs, you may find yourself without health care for a period. Here are some tax consequences you should know about, as well as tips to fix a coverage gap.

Coverage gap tax issues

You will have to pay a penalty in 2018 if you don't have health care coverage for three consecutive months or more. Last year the annual penalty was equal to 2.5 percent of your household income, or \$695 per adult (and \$347.50 per child), whichever was higher. The 2018 amounts will be slightly higher to adjust for inflation.

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How to handle a gap in health care coverage(Cont'd)

Example: Susan lost her job-based health insurance on Dec. 31, 2016, and applied for a plan through her state's insurance marketplace program on Feb. 15, 2017, which went into effect on March 1, 2017. Because she was without coverage for three months, she owes a fourth of the penalty on her 2017 tax return (three of 12 months uncovered, or 1/4 of the year).

While the penalty is still in place for tax years 2018 and earlier, it is eliminated starting in the 2019 tax year by the Tax Cuts and Jobs Act.

Three ways to handle a gap

There are three main ways to handle a gap in health care coverage:

1. **COBRA.** If you're in a coverage gap because you've left a job, you may be able to keep your previous employer's health care coverage for up to 18 months through the federal COBRA program. One downside to this is that you'll have to pay the full premium yourself (it's typically split between you and your employer while you are employed), plus a potential administrative fee.
2. **Marketplace.** You can enroll in an insurance marketplace health care plan through Healthcare.gov or your state's portal. Typically you can only sign up for or change a Marketplace plan once a year, but you can qualify for a 60-day special enrollment period after you've had a major life event, such as losing a job, moving to a new home or getting married.
3. **Applying for an exemption.** If you are without health care coverage for an extended period, you may still avoid paying the penalty by qualifying for an exemption. Valid exemptions include unaffordability (you must prove the cheapest health insurance plan costs more than 8.16 percent of your household income), income below the tax filing threshold (which was \$10,400 for single filers below age 65 in 2017), ability to demonstrate certain financial hardships, or membership in certain tribal groups or religious associations.

Audit rates decline for 6th year in a row

IRS audit rates declined last year for the sixth year in a row and are at their lowest level since 2002, the agency reported. That's good news for people who don't like to be audited (which is everybody)!

- **Low statistics** for audit examinations obscure the reality that you may still have to deal with issues caught by the IRS's automated computer systems. These could be math errors, typos or missing forms. While not as daunting as a full audit, you need to keep your records handy to address any problems.

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Audit rates decline for 6th year in a row (Cont'd)

- **Average rates** are declining, but audit chances are still high on both ends of the income range: no-income and high-income taxpayers.
- **No-income taxpayers** are targets for audits because the IRS is cracking down on fraud in refundable credits designed to help those with low income, such as the Earned Income Tax Credit (EITC). The EITC can refund back more than a low-income taxpayer paid in, so scammers attempt to collect these refund credits through fraudulent returns.
- **High-income taxpayers** have increasingly been a target for IRS audits. Not only do wealthy taxpayers tend to have more complicated tax returns, but the vast majority of federal income tax revenue comes from wealthy taxpayers. Based on the statistics, the very highest income taxpayers can assume they will be audited about every six years.
- **Complicated returns** are more likely to be audited. Returns with large charitable deductions, withdrawals from retirement accounts or education savings plans, and small business expenses and deductions are reportedly more likely to be the subject of an audit.

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