# Section 4: Taxation and Advice

## Part 4.2 Advising the Taxpayer

## 1. Reporting obligations for Individuals

# Reporting obligations for Individuals

Tax planning is arranging financial affairs to minimize tax liability. The process is encouraged as long as legal methods are used. When illegal methods are used, tax planning is replaced by tax evasion, which is subject to fines, penalties and incarceration. Tax planning; however, should never outweigh the overall business goals. Additionally, all tax planning requires that taxpayers understand taxes and avoid tax traps. Taxpayers must also understand tax terminology. The average tax rate is the rate applied to the taxpayer's income. The marginal tax rate represents the rate at which tax is imposed on the "next" dollar of income. The marginal tax rate is the most important tax rate in tax planning. Tax planning is particularly focused on timing of transactions.

Form W-2 is used to report wages, tips and other compensation paid to employees.

# Reporting obligations for Individuals

These forms must be furnished to employees by January 31 of the following calendar year. Form W-3 must be filed with the Social Security Administration by February 28 of the year following the calendar year of payment. Also, gambling winnings are reported on a Form W-2G. Form W-3G is sent to the IRS by February 28 of the year following payment. Form 1099 is used to report the earnings of nonemployees. A Form 1096 must be transmitted to the appropriate IRS Service Center by February 28 of the year following the calendar year of payment. Employees should complete a Form W-4 to establish their filing status and number of withholding allowances. Employees may have additional amounts withheld from their wages, which can be authorized on a Form W-4. Single employees with only one job may claim one special withholding allowance. Married employees may also claim the special withholding allowance if the employee has only one job and the spouse does not work or wages earned from a second job, or the spouse's job, are $1,500 or less

# Reporting obligations for Individuals

Federal withholding is computed based on gross wages before Social Security taxes, pension payments, union dues, insurance and other deductions. Most accounting software has the withholding tables in the payroll programs. The withholding tables are included in IRS Publication 15. Withholding taxes are required on pension and other deferred income payments

For periodic payments, rates are based on the taxpayer's withholding certificate as if the payments were additional wages. For non-periodic payments, the withholding is a flat 10 percent, except for certain distributions that have a required 20 percent withholding. Tips are also subject to taxation. Employers are not required to withhold income, Social Security, or Medicare taxes on allocated tips, but are required to collect those taxes on tips reported by employees. Individuals may be subject to backup withholding on payments such as interest and dividends. The payor must withhold 28 percent for payments made to the taxpayers.

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## 2. Property Sales

# Property Sales

A seller of any age who has owned and used a home as a principal residence for at least two of the last five years can exclude from income up to $250,000 of gain ($500,000 for joint filers) on the sale of the residence. Generally, this exclusion may only be used once every two years. Personal residences include single-family homes, mobile homes, houseboats, condominiums, cooperative apartments, duplexes or row houses. Married taxpayers can exclude the full $500,000 if either spouse owned the home for at least two of the last five years, both spouses used the home as a principal residence of at least two of the last five years and neither spouse has used the exclusion during the prior two years.

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## 4.2 Advising the Taxpayer

### 3. Education Planning

# Education Planning

Qualified Tuition Programs (QTP) allow taxpayers to buy in-kind tuition credits or certificates for qualified higher education expenses or to contribute to an account established to meet qualified higher education expenses. A state government or private institutions of higher learning sponsor the programs. Qualified higher education expenses include tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible education intuition. There is no income limit on the amount of contributions to the QTP, however, the contributions are not tax deductible. The contributions are considered gifts, thus subject to gift tax rules. Educational savings accounts are established to pay for qualified higher education expenses.

# Education Planning

One of the many benefits of saving for a child's future college education is with a 529 plan. Contributions are considered gifts for tax purposes. In 2019 gifts totaling up to $15,000 per individual will qualify for the annual gift tax exclusion.

Contributions can be made until the designated beneficiary reaches 18. Additionally, contributions cannot be made to educational savings accounts in the same year a contribution is made to a Qualified Tuition Program.

# Education Planning

Contributions to educational savings accounts are phased out between AGIs of $95,000 and $110,000 for single taxpayers and $190,000 and $220,000 for married couples filing a joint return.

Taxpayers are allowed an “above-the-line” deduction for qualified tuition and related expenses. Certain items must reduce the total amount of qualified tuition and related expenses. The reduction applies to excludible interest from higher education savings bonds, excludible distributions from qualified state tuition plans and excludible distributions from educational savings accounts. The deduction is limited to $4,000 for a single taxpayer with modified adjusted gross income below $65,000 and married filing jointly taxpayers with modified adjusted gross income below $130,000. The deduction is limited to $2,000 for a single taxpayer with modified adjusted gross income between $65,000 and $80,000 and for married file jointly with modified AGI between $130,000 and $160,000.

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## 4. Estate Planning

# Estate Planning

The Estate Tax is a tax on your right to transfer property at your death. It consists of an accounting of everything you own or have certain interests in at the date of death (Refer to Form 706. The fair market value of these items is used, not necessarily what you paid for them or what their values were when you acquired them. The total of all of these items is your "Gross Estate." The includible property may consist of cash and securities, real estate, insurance, trusts, annuities, business interests and other assets.

Once you have accounted for the Gross Estate, certain deductions (and in special circumstances, reductions to value) are allowed in arriving at your "Taxable Estate." These deductions may include mortgages and other debts, estate administration expenses, property that passes to surviving spouses and qualified charities. The value of some operating business interests or farms may be reduced for estates that qualify. After the net amount is computed, the value of lifetime taxable gifts (beginning with gifts made in 1977) is added to this number and the tax is computed. The tax is then reduced by the available unified credit.

# Section 4: Taxation and Advice

## 4.2 Advising the Taxpayer

## 5. Retirement Planning

# Retirement Planning

Qualified retirement planning services are any retirement planning services provided to an employee and his spouse by an employer maintaining a “qualified employer plan.” The exclusion does not apply to services that may be related to tax preparation, accounting, legal or brokerage services.

**Types of Retirement Plans:**

- Individual Retirement Arrangements (IRAs), Roth IRAs, 401(k) Plans
- 403(b) Plans, SIMPLE IRA Plans (Savings Incentive Match Plans for Employees), SEP Plans (Simplified Employee Pension),
- SARSEP Plans (Salary Reduction Simplified Employee Pension),
- Payroll Deduction IRAs, Profit-Sharing Plans, Defined Benefit Plans
- Money Purchase Plans, Employee Stock Ownership Plans (ESOPs)
- Governmental Plans, 457 Plans, 409A Nonqualified, Deferred Compensation Plans

# Section 4: Taxation and Advice

## 4.2 Advising the Taxpayer

## 6. Marriage and Divorce

# Marriage and Divorce

**Divorced persons.** If you are divorced under a final decree by the last day of the year, you are considered unmarried for the whole year.

**Divorce and remarriage.** If you obtain a divorce for the sole purpose of filing tax returns as unmarried individuals, and at the time of divorce you intend to and do, in fact, remarry each other in the next tax year, you and your spouse must file as married individuals in both years.

**Please see the Addendum to this Section**

# Section 4: Taxation and Advice

## 4.2 Advising the Taxpayer

## 7. Items that will Affect Future Returns ( e.g., carryovers, net operating loss, Schedule D, and Form 8801)

# Items that will Affect Future Returns ( e.g., carryovers, net operating loss, Schedule D,  Form 8801)

The NOL has been carryback has been eliminated.

The Tax Cuts and Jobs Act ( TCJA), Section 13302, eliminated the option for most taxpayers to carry back a net operating loss (NOL).

NOL arising in tax years ending after 2017 can only be carried forward.

The 2-year carryback rule in effect before 2018, generally, does not apply to NOLs arising in years ending after December 31, 2017.

An exception applies to certain farming losses.

# Section 4: Taxation and Advice

## 4.2 Advising the Taxpayer

## 8. Injured Spouse

# Injured Spouse

You are an injured spouse if you file a joint tax return and all or part of your portion of the overpayment was, or is expected to be applied (offset) to your spouse's legally enforceable past-due federal tax, state income tax, state unemployment compensation debts, child or spousal support, or a federal nontax debt, such as a student loan.

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## 9. Innocent Spouse

# Innocent Spouse

To qualify for innocent spouse relief, you must meet all of the following conditions.

- You must have filed a joint return which has an understated tax.
- The understated tax must be due to erroneous items of your spouse (or former spouse).
- You must establish that at the time you signed the joint return, you did not know, and had no reason to know, that there was an understated tax.
- Taking into account all of the facts and circumstances, it would be unfair to hold you liable for the understated tax.
- You must request relief within 2 years after the date on which the IRS first began collection activity against you after July 22, 1998.

**Please See the Addendum to this Section**

# Section 4: Taxation and Advise

## 4.2 Advising the Taxpayer

## 10. Estimated Tax

# Estimated Tax

Estimated tax is the method used to pay tax on income that is not subject to withholding. This includes income from self-employment, interest, dividends, alimony, rent, gains from the sale of assets, prizes, and awards. You also may have to pay estimated tax if the amount of income tax being withheld from your salary, pension, or other income is not enough. Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes and amounts reported on your tax return. If you do not pay enough tax, either through withholding or estimated tax, or a combination of both, you may have to pay a penalty. If you do not pay enough by the due date of each payment period (see When To Pay Estimated Tax, later), you may be charged a penalty even if you are due a refund when you file your tax return.

**Please see the Addendum to this Section**

# Section 4: Taxation and Advice

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## 11. Adjustments, Deductions, and Credits for Tax Planning

# Adjustments, Deductions, and Credits for Tax Planning

This section is an introductory preview of what expenses are deductible *for* adjusted gross income and *from* adjusted gross income This is crucial information because a deduction *for* AGI is more beneficial than a deduction *from* AGI.

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## 12. Use of Capital Gain Rates Verses Ordinary Income Rates

# Use of Capital Gain Rates Verses Ordinary Income Rates

Almost everything you own and use for personal or investment purposes is a capital asset. Examples include a home, personal use items like household furnishings, and stocks or bonds held as investments. When a capital asset is sold, the difference between the basis in the asset and the amount it is sold for is a capital gain or a capital loss. Generally an asset's basis is its cost, however, if you received the asset as a gift or inheritance, refer to Topic 703 for information about your basis. You have a capital gain if you sell the asset for more than your basis. You have a capital loss if you sell the asset for less than your basis. Losses from the sale of personal-use property, such as your home or car, are not deductible.

**Please Refer to the Addendum for this Section**