

## **2017 CLIENT NEWSLETTER**

### *Income Tax Highlights*



*A publication of the Minnesota Association of Public Accountants*

The Minnesota Association of Public Accountants prepared this newsletter. It is not intended to be inclusive. Any questions concerning the contents, or other tax questions, should be directed to your MAPA Accountant.

## **INDIVIDUAL HIGHLIGHTS**

### **WHEN DOES A DEPENDENT HAVE TO FILE A RETURN**

A dependent has to file a return if the dependent has:

1. Earned income only and the total is more than \$6,350.
2. Unearned income only (i.e. income which is not compensation for services) and the total is more than \$1,050.
3. Both earned and unearned income and the unearned income is more than \$350 or the total income is more than \$6,350.

### **KIDDIE TAX**

Children who have investment income greater than \$2,100 may be subject to tax based on their parent's income. This tax has been expanded in a very complex manner to potentially apply to children under age 24 as of yearend. This extended version of the kiddie tax targets two groups who have attained age 18: 1) those who reach their 18th birthday during the year, and 2) those in full-time student status for at least five months of the year who attain their 19th through 23rd birthday during the tax year. There is a further test for those in the age 18-23 groups. The kiddie tax only applies if the earned income of the child (wages and self-employment income) does not exceed one-half of the child's support for the tax year. In calculating support, amounts covered by scholarships are not taken into account. The tax does not apply to a child who is married and files a joint return for the tax year.

### **INDIVIDUAL MANDATE**

Beginning January 1, 2014, all individuals who do not meet certain exemption criteria must have minimum essential health insurance coverage. Nonexempt individuals who do not maintain the required health insurance coverage for themselves and any nonexempt dependents are subject to a shared responsibility penalty for each month that the required insurance is not maintained.

For 2017, if you don't have coverage you'll pay the greater of (i) \$695 per person for the year (\$347.50 per child under 18) up to a maximum penalty per family of \$2,085, or (ii) 2.5% of your household income over the applicable filing threshold. The penalty is capped at the national average premium for a bronze plan. You must make the shared responsibility payment when you file your federal income tax return. Married individuals who file a joint return for a tax year are jointly liable for any shared responsibility payment.

### **NET INVESTMENT INCOME TAX**

For 2017, an additional 3.8% Net Investment Income Tax (NIIT) will be assessed on taxpayers with a modified adjusted gross income (MAGI) exceeding \$250,000 for those filing jointly, or surviving spouse, \$200,000 for head of household and single, \$125,000 for those filing married filing separately. The tax is 3.8% of the lesser of net investment income or the excess of MAGI over the threshold amount.

## INDIVIDUAL HIGHLIGHTS (continued)

### ADDITIONAL .9% MEDICARE TAX

An individual is liable for additional Medicare tax if the individual's wages, compensation, or self-employment income (together with that of his or her spouse if filing a joint return) exceed the threshold amount for the individual's filing status. The threshold amounts are: \$250,000 for married filing jointly, \$125,000 for married filing separately, and \$200,000 for all others.

### PERSONAL EXEMPTION

The exemption for 2017 is \$4,050. For a parent to claim an exemption for a full-time student, who earns more than \$4,050, the student must be under 24 years of age as of the close of the year. A full time student must attend school for at least 5 calendar months.

Exemption phase out: the adjusted gross income thresholds where the personal exemption starts to be reduced are \$261,500 for single, \$313,800 for married filing joint and surviving spouse, \$287,650 for head of household and \$156,900 for married filing separately.

### STANDARD DEDUCTIONS

<b>Filing Status:</b>		<b>Additional for elderly and/or blind</b>
Single	\$6,350	\$1,550
Head of Household	\$9,350	\$1,550
Married Filing Joint	\$12,700	\$1,250
Married Filing Separately	\$6,350	\$1,250

If an individual can be claimed as a dependent on another taxpayer's return, the regular standard deduction is limited to \$1,050 or the dependent's earned income plus \$350 up to the regular standard deduction. If the individual is over 65 years of age and/or blind, the additional deduction will be added to the above.

### ITEMIZED DEDUCTIONS

For 2017 and future years higher income taxpayers are required to phase out up to 80% of certain itemized deductions.

The phase out applies to taxpayers with AGI over a threshold amount: \$261,500 (single), \$313,800 (married filing jointly), \$287,650 (head of household), or \$156,900 (married filing separately). These threshold numbers are adjusted for inflation after 2017. Basically, deductions are reduced by 3% of the amount by which AGI exceeds the threshold. However, deductions for medical expenses, investment interest, casualty and theft losses, and gambling losses are not subject to the limitation.

### STANDARD MILEAGE ITEMIZED DEDUCTION RATES

The standard mileage rate allowances for 2017 are 14 cents for charitable miles and 17 cents for moving and medical.

### STUDENT LOAN INTEREST

Taxpayers paying qualified education loans may be able to deduct up to \$2,500 of interest on the loans in 2017. There is a phase out that begins for taxpayers with modified adjusted gross income above \$65,000 for single taxpayers and \$135,000 for married filing joint taxpayers.

### PREMIUM ASSISTANCE CREDIT

Beginning in 2014, certain low-income and moderate-income individuals are eligible for a refundable income tax credit to help pay for the health insurance coverage in a qualified health plan purchased through a Health Insurance Marketplace also known as the Exchange. Individuals can elect to have the estimated credit amount paid directly to the insurer to help pay monthly health insurance premiums during the calendar year. These are called advance payments. Generally, taxpayers eligible for the credit have household income for the tax year of at least 100%, but not more than 400% of the federal poverty line, and do not have access to employer-sponsored affordable coverage that provides a minimum value. A taxpayer whose advance credit payments exceed the final premium tax credit owes the excess as an additional income tax liability. The IRS has placed limits on the amount of the credit the taxpayer has to pay back based on household income.

### CHILD TAX CREDIT

In 2017, the nonrefundable credit for each child under the age of 17 is \$1,000. For taxpayers with incomes above \$75,000 (\$110,000 married filing joint), the credit is phased out by \$50 for each \$1,000 of adjusted gross income above the threshold amount. For taxpayers whose tax liability is not large enough to fully utilize the allowable credit, the unused credit is refundable to the extent of 15% of the taxpayers earned income in excess of \$3,000.

## **INDIVIDUAL HIGHLIGHTS (continued)**

### **ADOPTION CREDIT**

The adoption credit can now be taken on expenses up to \$13,570. The phase out applies for filers with AGIs between \$203,540 and \$243,540. For 2017, the adoption credit isn't refundable. That means that the credit can be claimed only up to the amount of your tax liability.

### **AMERICAN OPPORTUNITY TAX CREDIT**

The American Recovery and Reinvestment Act of 2009 created a \$2,500 higher education tax credit that is available for the first four years of college. The credit is based on 100% of the first \$2,000 of tuition and related expenses (including books) paid during the tax year and 25% of the next \$2,000 of tuition and related expenses paid during the tax year, subject to a phase-out for AGI in excess of \$80,000 (\$160,000 for married couples filing jointly). 40% of the credit is refundable.

### **LIFETIME LEARNING CREDIT**

If a taxpayer, spouse, or dependent is a student, the taxpayer may be eligible for a nonrefundable credit of up to \$2,000 (20% of the first \$10,000 of qualified tuition and expenses). The credit is allowed for an unlimited number of years on a per taxpayer basis. It covers all 4 years of post-secondary education as well as graduate school and courses to improve job skills. There is a phase out for taxpayers with modified adjusted gross income above \$56,000 (\$112,000 married filing joint).

### **RESIDENTIAL ENERGY EFFICIENT PROPERTY CREDIT**

Taxpayers are allowed a 30% credit for the purchase of qualified property placed in service during 2017:

- Qualified solar energy property used to generate electricity.
- Qualified solar water heating property.

### **PENALTY FREE IRA WITHDRAWALS**

Penalty free withdrawals (prior to age 59 ½) from all IRA's are permitted for 1) undergraduate and graduate expenses (tuition, books, and room and board) for taxpayer, spouse, children or grandchildren; 2) up to \$10,000 for first-time homebuyers, defined as taxpayer(s) who has not owned a home for two years; 3) payment of medical expenses greater than 10% of AGI; and 4) certain hardship exceptions. An IRA withdrawal is still subject to income tax. Be aware that if you opened your ROTH IRA less than five years prior to a distribution, the 10 percent penalty can be avoided but there may be tax on the earnings that are withdrawn.

### **COVERDELL EDUCATION SAVINGS ACCOUNTS (FORMERLY EDUCATION IRA)**

Up to \$2,000 per beneficiary per year can be contributed to an education savings account for a beneficiary under age 18, regardless of whether the contributor or the beneficiary has any earned income. It is nondeductible and is phased out pro rata as modified adjusted gross income increases from \$95,000 to \$110,000 single (\$190,000 to \$220,000 married filing joint). A Coverdell ESA can be used to pay elementary and secondary, as well as higher education expenses.

### **HOME OFFICE EXPENSES**

Expenses related to a home office are generally deductible if, (1) you use the office exclusively on a regular basis as your principal place of business or a place patients, clients, or customers use in meeting or dealing with you; (2) you are an employee and the business use is for the convenience of your employer; or (3) you use it exclusively and regularly for administrative and management activities of your business if there is no other fixed location to perform such activities.

Effective for tax years beginning on or after January 1, 2013, the IRS allows a safe harbor business use of home deduction at a rate of \$5 per square foot for the portion of the home used in the qualified business, but not to exceed 300 square feet.

### **ESTIMATED TAX PAYMENTS**

No penalty for failure to pay estimated tax applies for taxes payable of less than \$1,000. Household taxes must be included in estimates. If you don't meet this exception, you are required to pay the lower of: (1) at least 90% of the tax shown on the current year return, or (2) 100% of the tax shown on the prior year's return. For individuals with adjusted gross income for 2017 in excess of \$150,000, the estimated payments should be 110% of the prior year tax liability.

### **SOCIAL SECURITY EARNINGS LIMITS**

The earnings limit for 2017 is \$16,920 for retirees ages 62 up to full retirement age (FRA). One dollar must be repaid for every two dollars earned over this figure. For those reaching FRA in 2017, the earnings limit for the months prior to reaching FRA is \$44,880. Starting in the month that you reach your FRA, there are no limits on your earnings.

## **INDIVIDUAL HIGHLIGHTS (continued)**

### **TAXABLE SOCIAL SECURITY INCOME**

Social Security income may be taxable depending on other income received. The maximum amount of Social Security income that can be included in taxable income is 85%.

### **SOCIAL SECURITY PAID BY WAGE EARNERS AND SELF-EMPLOYED INDIVIDUALS**

Social security withheld from employee wages and calculated on self-employment income is composed of two parts: FICA (Federal Insurance Compensation Act) of 12.4% and Medicare of 2.9% which has basically remained unchanged since 1990. Half of this is paid by the employee and the other half by the employer. Self-employed individuals pay the entire amount. For tax year 2017, the FICA limit is \$127,200. Wages and self-employment income over \$127,200 is subject only to the Medicare tax.

### **GAIN FROM SALE OF PRINCIPAL RESIDENCE**

A taxpayer generally may exclude up to \$250,000 (\$500,000 on a joint return) of gain realized on the sale or exchange of a principal residence. The taxpayer must have owned and occupied the residence as a principal residence for at least two of the five years before the sale or exchange.

The IRS Reform Act says homeowners can receive a portion of the exclusion based on how long they live in the home as long as the move is due to a change in place of employment, health, or unforeseen circumstances.

If a second home or rental property is converted to a principal residence after January 1, 2009, be aware that prior depreciation and/or some of the gain may be taxable.

### **CAPITAL GAINS FOR INDIVIDUALS**

In 2017 the maximum capital gains rate for sales of long-term capital assets (held more than 12 months) is 20% for taxpayers in the 39.6% tax bracket and 15% for taxpayers in the 25%-35% brackets. (0% for taxpayers in the 10% and 15% brackets). For 2017, qualified dividends will continue to be taxed at the same rates as long-term capital gains.

### **INDIVIDUAL IRA CONTRIBUTIONS (TRADITIONAL OR ROTH)**

If you and/or your spouse have taxable compensation (earnings subject to FICA and Medicare tax), you may be able to contribute to an Individual Retirement Account. The maximum Traditional IRA or ROTH IRA contribution for 2017 is \$5,500 if under the age of 50 and \$6,500 if age 50 or older as of the end of the year. Taxable deductions for contributions to a Traditional IRA may be limited if you or your spouse are covered by an employer provided retirement plan and if your income exceeds certain levels. Contributions to a Traditional IRA are not allowed in the year you reach 70 1/2 and older. ROTH IRA contributions may be limited by your filing status and income. Contributions to any IRA account can be made up to the filing deadline of your tax return without extension. Excess contributions and income earned on the excess amount are subject to penalty if not withdrawn prior to the due date of your individual income tax return (including extension).

### **HEALTH SAVINGS ACCOUNT CONTRIBUTIONS (HSA)**

If your health insurance meets the guidelines, you may be able to contribute to a Health Savings Account. For 2017, the maximum HSA contribution for a single taxpayer plan is \$3,400 with a minimum deductible of \$1,300. The maximum HSA contribution for a family plan is \$6,750 with a minimum deductible of \$2,600. There is an additional allowed contribution of \$1,000 if you are age 55 or older as of the end of the year. Contributions to an HSA account can be made up to the filing deadline of your tax return without extension. Excess contributions are not deductible and are subject to penalty unless the excess contributions are paid out to the account holder before the tax return deadline including extensions.

## BUSINESS HIGHLIGHTS

### STANDARD MILEAGE AND PER DIEM RATES

The standard mileage rate allowance under the optional method for vehicle expense for 2017 is 53.5 cents per business mile.

The IRS has provided optional per diem allowances for lodging and meals and incidental expenses (M&IE) while traveling for business and away from home. These are calculated using a high-low method based on the locality visited. The 2017 and 2018 daily rate is \$282 and \$284, respectively, for travel to any “high-cost locality”, which includes a \$68 M&IE component for both years and \$214 and \$216 for lodging.

The 2017 and 2018 daily rate is \$189 and \$191, respectively, for travel to any “low-cost locality”, which includes a \$57 M&IE component for both years and \$132 and \$134 for lodging. The 2017 and 2018 rates are effective for per diem allowances that are paid to an employee on or after October 1, 2016 or October 1, 2017, respectively, for travel away from home on or after October 1, 2016 or October 1, 2017 respectively.

The special M&IE rate for the transportation industry is \$63 per day in the continental US and \$68 per day outside the continental US.

### HEALTH DEDUCTION FOR SELF-EMPLOYED

The self-employed health insurance deduction for 2017 is 100%. Effective March 30, 2010, the self-employed health insurance deduction may also be claimed by a taxpayer with respect to a child who has not attained age 27 by the end of the tax year

In early 2011, the IRS has revised its guidance and reversed its position by stating in the 2010 Form 1040 instructions that “Medicare Part B premiums can be used to figure the deduction.” IRS guidance would suggest that Medicare Part D premiums would also qualify.

### SECTION 179 (DEPRECIATION)

Subject to a dollar limit, the election allows you to deduct, in the tax year for which the election is made, the cost of qualifying property placed in service during the tax year. The immediate deductions allowed are in lieu of capitalization and later depreciation deductions. The annual deduction limit is \$510,000. The deduction is phased out (i.e., gradually reduced) if more than a specified amount of qualifying property is placed in service during the tax year. The amount is \$2,030,000 for 2017. The annual deduction limit and qualifying dollar limitation is now indexed for inflation.

### SPECIAL DEPRECIATION ALLOWANCE (BONUS DEPRECIATION)

At various times since 2001, 30%, 50%, and 100% special depreciation allowances have been available to recover the cost of qualified property. The property must be new property, and the original use of the property must have begun with the taxpayer. Used property does not qualify for the special depreciation allowance.

**New Law:** The special depreciation allowance was an extender item for several years, allowed to expire then retroactively extended by Congress. Legislation passed in December of 2015 extended the 50% bonus depreciation through 2019 (2020 for certain longer-lived and transportation property). The percentage is phased down 10% per year beginning in 2018.

**Qualifying property:** The following types of property qualify for the 50% special depreciation allowance:

- MACRS property with a recovery period of 20 years or less.
- Water utility property.
- Off-the-shelf computer software that is not a Section 197 intangible asset.
- Qualified improvement property.
- Certain long production period and transportation property.
- Qualified cellulosic biofuel plant property.

### SMALL BUSINESS HEALTH CARE TAX CREDIT

This credit is for small employers, less than 25 full-time workers who cover at least 50% of the cost of health care coverage for some of its workers based on the single rate. The employer must pay average annual wages below \$52,400. This credit is worth up to 50% of a small business’ premium costs in 2017. However, for tax years beginning after 2013, the credit is only available if the employer purchases health insurance coverage for its employees through an Exchange.

### MONTHLY PAYROLL DEPOSIT THRESHOLD

If your Form 941 payroll tax liability is under the \$2,500 threshold, employers in a return period are not required to make monthly deposits or make the payment online through EFTPS. The amount can be remitted with the Form 941 and the 941-V payment voucher. Also, if your Form 940 tax liability is less than \$500, you can make the tax payment with Form 940 and the 940-V payment voucher.

## MINNESOTA HIGHLIGHTS

### NEW FOR 2017

Minnesota Gov. Mark Dayton signed an omnibus tax bill that makes a number of changes to corporate franchise (income) and personal income taxes, including establishing new subtraction modifications, new credits, and requiring electronic filing of corporate, partnership, and fiduciary returns for certain professional tax preparers. Here is a summary of the bill's notable provisions:

#### Subtraction for contributions to 529 plans

Effective for tax years beginning after 2016, the legislation allows personal income taxpayers to subtract up to \$1,500 (\$3,000 for married joint filers) of contributions to any state's Sec. 529 college savings plan or prepaid tuition plan. The subtraction excludes amounts that are rolled-over from other college savings plans and is limited to taxpayers who do not claim the new Sec. 529 savings plan credit.

Section 529 college savings plan credit. Effective for tax years beginning after 2016, the legislation creates a non-refundable income tax credit for contributions to any state's Sec. 529 college savings plan, including prepaid tuition plans. For individual filers and married couples, the credit is available in an amount equal to 50% of contributions, up to a maximum of \$500. For individual filers, the maximum credit is phased out by two percent of adjusted gross income in excess of \$75,000. The credit is fully phased out for individual filers at \$100,000 of adjusted gross income. For married couples filing joint returns, the maximum credit is phased out in two stages, and is fully phased out when AGI reaches \$160,000.

#### Student loan credit

The recently enacted legislation establishes credit for principal and interest payments on higher education loans, effective for tax years beginning after 2016. The maximum credit is \$500 each year (or \$1,000 for married couples who file a joint return if both spouses made payments on a qualified loan) In order to qualify for the credit, a taxpayer must have one or more qualified education loans. "Qualified education loan" is defined as any loan used to pay for the costs of attending an undergraduate or graduate degree program at an educational institution eligible for federal financial aid, including federal direct and Perkins loans, state loans, and private student loans.

#### Subtraction for Social Security benefits

The recently enacted legislation creates a personal income tax subtraction for an amount of certain Social Security benefits for tax years beginning after 2016. The maximum subtraction is \$4,500 for married couples filing joint returns, \$3,500 for single and head of household filers, and \$2,250 for married couples filing separate returns. The subtraction is reduced by 20% of provisional income over specified income thresholds.

To see a list of all the changes new for 2017 and for future years, visit:

[http://www.revenue.state.mn.us/individuals/individ\\_income/Pages/What-s-New.aspx](http://www.revenue.state.mn.us/individuals/individ_income/Pages/What-s-New.aspx)

### TAX RATES

Individual income tax rates are 5.35%, 7.05%, 7.85% and 9.85%. The AMT rate is 6.75%.

### EDUCATION TAX CREDIT

Families with children in grades K-12 may qualify for a refundable tax credit of up to \$1,000 per child for educational expenses paid during the year. The income and credit limits are based on the number of qualifying children. For families with 1 or 2 children, household income must be below \$37,500. For families with more than 2 children, the income limit increases by \$2,000 per child.

### SUBTRACTION FOR SCHOOL EXPENSES

You may subtract a maximum of \$1,625 per qualifying child (K-6) and \$2,500 (grades 7-12) for qualifying expenses. There is no family maximum deduction. The term "qualifying child" is the same as the federal definition of a qualifying child for Earned Income Credit purposes. This will allow a custodial parent who makes educational expenditures for his or her child to claim the subtraction even if the non-custodial parent claims the child as a dependent.

### MINNESOTA WORKING FAMILY CREDIT

Families that qualify for the federal earned income credit also qualify for the Minnesota Working Family Credit. Schedule M1WFC needs to be completed to determine the amount of the credit.

## MINNESOTA HIGHLIGHTS (continued)

### MARRIAGE CREDIT

The marriage credit for 2017 provides married taxpayers who each have at least \$23,000 of earned income, a credit against the Minnesota regular tax. The credit ranges from \$5 to a maximum of \$1,433.

### CHARITABLE DEDUCTIONS

Individuals who do not itemize on their federal income tax return are allowed to subtract contributions that would be charitable deductions under the IRS code. Up to 50% of the total contributions for the year in excess of \$500 can be subtracted.

### MINNESOTA SECTION 179 (DEPRECIATION)

Minnesota limits Section 179 to \$25,000 with an investment limit of \$200,000.

Minnesota allows taxpayers to claim the full bonus amount, but it's apportioned over a six-year period. In the year the asset is placed in service, taxpayers get 20% of the bonus depreciation. They must add back the remaining 80% to taxable income, which is recovered when they subtract it from taxable income over the next five years.

### MILITARY PERSONNEL

Minnesota residents, on active duty, stationed outside of Minnesota are no longer considered nonresidents for income tax purposes. However, you are allowed a subtraction for military compensation, if included in federal taxable income, including Active Guard Reserve (AGR) Program compensation earned under U.S. Code Title 32 and income earned under U.S. Code Title 10.

Beginning with tax year 2016, Minnesota will allow taxpayers to subtract certain military retirement pay (including pensions) when calculating Minnesota taxable income and Minnesota alternative minimum taxable income. To qualify for this subtraction, the retirement pay must be taxable on the federal return, and for:

- Service in the active component of the military (U.S. Code Title 10, sections 1401 to 1414),
- Retirement pay for service in the reserve component (U.S. Code Title 10, section 12733), or
- Survivor benefit plan payments (U.S. Code Title 10, sections 1447 to 1455).

To claim the subtraction you must file Schedule M1M, Income Additions and Subtractions. Taxpayers who claim this subtraction may not claim the nonrefundable credit for past military service

A Minnesota resident who served in a combat zone or qualifying hazardous duty area at any time from January 1, 2013 through December 31, 2017 may be eligible for a refundable credit. The credit for 2017 equals \$120 for each month or part month served in a combat zone for taxpayers whose military records indicate Minnesota as their home of record.

**Effective January 1, 2013:** If you (and your spouse if filing a joint return) are a veteran of the military (including the National Guard and Reserves), you may qualify for a nonrefundable credit reducing your income tax by as much as \$750 for past service.

You can qualify for this credit if you have been separated from service and meet one or more of the following conditions:

- You served in the military for at least 20 years;
- You have a service-related disability rated by the U.S. Department of Veterans' Affairs as being 100 percent total and permanent; or
- You were honorably discharged and receive a pension or other retirement pay for service in the military.

Veterans with income of more than \$37,500 are not eligible for the credit.