

# tax report

JANUARY 2018



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## Helping Hurricane Victims

The IRS has announced it will grant favorable tax treatment to qualifying “leave-based donation programs” benefiting victims of Hurricanes Harvey, Irma, and Maria.\* Here’s how such programs work.

### Leave Donation Programs in General

Leave-based donation programs allow employees to donate the value of their unused vacation, sick, or personal leave time (paid time off, or PTO) in exchange for the employer making cash payments to a charitable organization. Under the tax rules that usually apply, the participating employee is deemed to have “constructively received” the PTO prior to donation. As a result, the value of the PTO must be included in the employee’s gross income (reported on Form W-2, *Wage and Tax Statement*) and is subject to both income and FICA (Social Security and Medicare) taxes. The employee may claim an itemized deduction for the charitable donation.

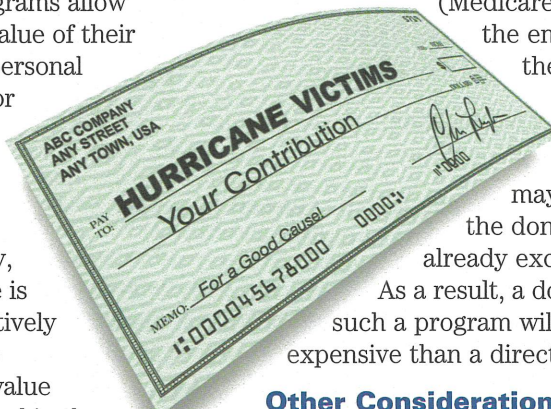
### Special Rules

More favorable tax rules will apply to leave-based donation programs benefiting victims of Hurricanes Harvey, Irma, and Maria:

■ The cash value of any PTO donated by an employer on behalf of an employee to a qualified charitable organization benefiting victims of these hurricanes will be *excluded* from gross income or wages, provided the payments are made to the charitable organization before January 1, 2019

■ Employers will be able to deduct such payments as ordinary and business expenses

Because the value of the leave-sharing donations does not have to be included in Box 1 (wages, tips, or other compensation), Box 3 (Social Security wages), or Box 5 (Medicare wages and tips) of the employee’s Form W-2, the employee saves on *both* income and FICA taxes. (No itemized deduction may be claimed for the donation because it was already excluded from income.) As a result, a donation made through such a program will generally be less expensive than a direct donation by check.



### Other Considerations

Exclusion of the donation from employment income will reduce the employee’s adjusted gross income (AGI), potentially allowing the employee to benefit from deductions and credits that decrease as AGI increases. For example, a lower AGI may allow an employee to take a larger deduction for contributions to a traditional individual retirement account.

Be aware, however, that — depending on how “compensation” is defined in your employer-sponsored retirement plan — participation in a leave donation program benefiting hurricane victims might reduce the amount of retirement plan contributions you can make. ■

\* IRS Notices 2017-48, 2017-52, and 2017-62

## It’s Not Over Yet

Although December 31 has come and gone, there’s still time for eligible taxpayers to:

**Fund an IRA.** 2017 contributions to a traditional or Roth individual retirement account (IRA) must be made by April 17, 2018. Traditional IRA contributions are potentially tax deductible, while Roth contributions are always made after tax. Eligibility requirements and contribution limits apply to both types of IRA.

**Contribute to an HSA.** Qualifying contributions to a health savings account (HSA) would reduce your adjusted gross income for 2017, provided you make them by April 17, 2018. As with an IRA, eligibility requirements and contribution limits apply.

**Use health FSA savings.** Flexible spending accounts (FSAs) for health care expenses are often subject to year-end, “use-it-or-lose-it” rules, but in some cases, FSAs allow an additional grace period of up to 2½ months after the plan’s year-end. Check your employer’s specific rules.



## short takes

### New COLAs for Retirement Plans

The IRS recently announced the cost-of-living adjustments (COLAs) to various retirement plan limits for 2018. Subject to individual plan limits, participants may contribute up to \$18,500 to 401(k), 403(b) and most 457 plans, and participants age 50 and older may contribute an additional \$6,000. Contribution limits for both traditional and Roth individual retirement accounts remain at \$5,500, plus an additional \$1,000 for taxpayers age 50 and older. Additional retirement plan limits were also announced.

### Increase in Per Diem Rates for Business Travel

The IRS has increased the “high-low” per diem rates for lodging, meals, and incidental expenses incurred for business travel in the continental United States. These rates apply when an employer chooses to provide a per diem allowance to traveling employees instead of reimbursing them for actual expenses. The per diem allowance will not count as taxable income if it does not exceed the IRS’s published rates and the employee complies with substantiation requirements. Under the new IRS notice, the “high” rate (to be used for identified “high-cost” areas) is \$284 (up from \$282), and the rate for all other areas is \$191 (up from \$189). The new rates are effective for travel after September 30, 2017.

*The general information in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.*

## Avoiding the 10% Early Withdrawal Penalty

Individuals saving for retirement in a qualified retirement plan, such as a 401(k) plan, or a traditional individual retirement account (IRA) need to remember that the IRS generally imposes a 10% penalty on withdrawals made before age 59½. (This penalty is *in addition to* any income taxes due on the withdrawal.) However, here are some of the exceptions that may apply.

### Qualified Plans and IRAs

Penalty-free early withdrawals from both IRAs and qualified plans may be allowed for:

- Payment of unreimbursed medical expenses that exceed a certain percentage of adjusted gross income
- Substantially equal periodic payments over your lifetime or the lifetimes of you and a beneficiary
- Your death or disability

### IRAs Only

If you own an IRA, you may be allowed to take penalty-free early withdrawals to pay other expenses, such as:

- First-time home buying expenses of up to \$10,000 (lifetime)

- Higher education expenses for you, your spouse, or a child or grandchild of you or your spouse
- Health insurance premiums if you collected unemployment compensation or could have if you had not been self-employed

### Qualified Plans Only

Early withdrawals from qualified plans aren’t subject to a penalty when the distribution is made for one of the following reasons:

- Separation from service with an employer if the separation occurs during or after the calendar year in which you attain age 55
- Distribution to a former spouse under a qualified domestic relations order

### Penalty Calculation

The 10% penalty applies only to the *taxable* portion of the distribution — that is, only to amounts contributed pretax or for which a deduction was previously taken (as well as any tax-deferred earnings). Determining the taxable portion of a distribution can be complex, so contact us if we can help. ■



## Social Security Cost-of-Living Adjustments

In October, the Social Security Administration announced cost-of-living adjustments (COLAs) for 2018. As a result, retirees will see a small increase in their monthly benefits, while higher earners will see more of their compensation taxed this year.

### Increase in Retirement Benefits

Retirees will see a modest 2.0% increase in their monthly benefits in 2018, with the estimated *average* monthly benefit increasing by \$27 to \$1,404 (or \$16,848 annually). This is the largest increase since 2012, when the COLA was 3.6%. Since then, increases have been 1.7% (2013), 1.5% (2014), 1.7% (2015), 0.0% (2016), and 0.3% (2017).

### Increase in Taxable Wage Base

There will also be a modest increase in

the Social Security taxable wage base to \$128,700, which is a 1.18% increase over the 2017 level of \$127,200.

The taxable wage base determines what amount of wage and self-employment income will be subject to the 6.2% Social Security tax. The tax is payable by both the employee and the employer, combining for a total tax rate of 12.4%, with the self-employed paying both portions of the tax.

As a result of this increase, an employee making an amount equal to or greater than the Social Security wage base could see his or her share of Social Security taxes increase to \$7,979.40 — or \$93 higher than the maximum payable in 2017. ■



# Crowdfunding — Exploring the Tax Implications

Crowdfunding — or funding a project through the online contributions of many different backers — is becoming increasingly popular. If you are considering raising crowdfunding revenue or contributing to a crowdfunding campaign, you will need to address the many tax issues that can arise.

## Background

While crowdfunding was initially used by artists and others to raise money for projects that were unlikely to turn a profit, others have begun to see crowdfunding as an alternative to venture capital. Depending on the project, those who contribute may receive nothing of value, a reward of nominal value (such as a T-shirt or tickets to an event), or perhaps even an ownership/equity interest in the enterprise.

## Is It Income?

In an “information letter” released in 2016,\* the IRS stated that crowdfunding revenues will generally be treated as income unless they are:

- Loans that must be repaid
- Capital contributed to an entity in exchange for an equity interest in the entity
- Gifts made out of detached generosity without any “quid pro quo”

The IRS noted that the facts and circumstances of each case will determine how the revenue is to be characterized and added that “crowdfunding revenues must generally be included in income to the extent they are for services rendered or are gains from the sale of property.”

Frequently, the IRS learns of the activity because crowdfunding entrepreneurs have used a third-party payment network to process the contributions. Where transactions during the year exceed a specific threshold — gross payments in excess of \$20,000 and more than 200 transactions — that third party is required to send Form 1099-K (*Payment Card and Third-Party Network Transactions*) to the recipient and the IRS. Payments that do not meet the threshold are still potentially taxable.

## If It's Income

“Ordinary and necessary” business expenses are generally tax deductible, but deductions for expenses are limited if the IRS deems the activity a hobby rather than a trade or business. Generally, the IRS applies a “facts and circumstances” test to determine if you have a profit-making motive, which is necessary for a trade or business. For hobbies, expenses are deductible only to the extent that (a) they do not exceed gross income from the activity and (b) they, in combination with other miscellaneous expenses, exceed 2% of your adjusted gross income.

## New Businesses

Favorable deduction rules may be available for certain types of expenses incurred in starting a new business. If eligible, the business may elect to expense up to \$5,000 of those costs (subject to phaseout) in the year the business becomes active, with the remainder of the start-up expenditures deducted ratably over a 180-month period.

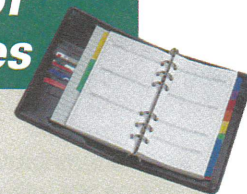
## For Contributors

Campaign contributors should not assume that their gifts qualify as tax-deductible charitable contributions. Tax-deductible contributions must meet certain requirements, including that they be made to a qualified charitable organization. If gifts are made to an individual or nonqualified organization, you will generally need to file a gift tax return for gifts to any one recipient that exceed the gift tax annual exclusion (\$15,000 for 2018).

These are just some of the potential tax issues that may arise. Please contact us if you would like to discuss crowdfunding in more detail. ■

\* Information Letter 2016-0036

## Calendar of Filing Dates



### JANUARY

**16 Individuals:** Pay last installment of 2017 estimated tax with Form 1040-ES. Or file 2017 income tax return and make full payment of any balance due by January 31, 2018.

**31 Employers:** Distribute copies of Forms W-2 for 2017 to employees and file same with the Social Security Administration.

**31 Businesses:** Distribute Forms 1099 (or other information statements) to recipients of certain payments made in 2017. See us for more details.

**31 Employers:** File Forms 1099-MISC if you are reporting nonemployee compensation payments in box 7.

**31 Employers:** File Form 941, Employer's Quarterly Federal Tax Return; quarterly deposit due.

**31 Employers:** File Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 2017.

### FEBRUARY

**12 Employers:** Deferred due date of Forms 940 and 941, if timely deposits were made.

**28 Businesses:** File 2017 Forms 1099 (with the exception of certain 1099-MISC forms, mentioned above) with the IRS. Electronic filers have until April 2 to file.

### MARCH

**15 Partnerships and S corporations:** File 2017 calendar-year partnership return (Form 1065) or S corporation return (Form 1120S). For an automatic six-month extension, file Form 7004.





## Tax Tips for the Self-employed

If you're self-employed, taxes are among your many responsibilities. Here are some tips to help keep you on track.

**Income taxes.** Sole proprietors do not file a separate federal income tax return for the business but instead summarize their business income and expenses on Schedule C of their personal income tax returns.

Keep complete records of your income and expenses. Deducting all your ordinary and necessary business expenses will help minimize your tax liability. Losses are generally deductible against your other income, subject to special rules relating to hobby losses, passive activity losses, and activities for which you were not "at risk."

**Self-employment taxes.** The self-employed must pay *both* shares of FICA (Social Security and Medicare) taxes,

though these are partially deductible. For 2018, the rates are as follows:

■ Social Security — 12.4% of the first \$128,700 of net self-employment earnings

■ Medicare — 2.9% of *all* net self-employment earnings\*

**Estimated tax payments.** Your net self-employment income will be taxable whether or not you withdraw cash from your business account. Moreover, you may be subject to penalties if you fail to make appropriate quarterly estimated tax payments.

**Home office.** If you work out of your home, you may be able to deduct a

portion of the costs incurred to maintain your home, as well as commuting expenses you incurred traveling from your home office to another work location.

**Health insurance.** When tax law requirements are met, you may deduct up to 100% of your health insurance premiums as a trade or business expense, including premiums paid for your spouse, dependents, and children under age 27.

**Retirement plan.** Several types of retirement plans are available to sole proprietors, including solo 401(k) plans and simplified employee pension plans. Contributions to these and other plans are tax deductible, within limits. ■

\* An additional 0.9% Medicare tax applies to the self-employment income of higher income taxpayers.

