

Tax Filing Changes and Traps for 2018

Changes under the Tax Cuts & Jobs Act aren't the only thing taxpayers need to watch for

Recent changes to our tax system will impact many of the things taxpayers are used to seeing on their tax returns. Even without those changes, though, other unique situations may require a taxpayer to be extra careful when filing their return this year.

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Taxpayers are beginning to prepare their 2018 tax returns, the first returns since the Tax Cut and Jobs Act of 2017 (TCJA) went into effect. Those changes will present plenty of confusion and complexity for do-it-yourself tax preparers, but it's a series of other topics – some new, some that have been around a long time – that could prove to be just as vexing for DIYers.

THE ALL NEW FORM 1040

There will be plenty of changes to see on tax forms this year due to the TCJA, but the biggest change has nothing to do with the 2017 tax reform. In an effort to simplify the tax forms, the [2018 Form 1040](#) has been condensed from 79 lines to just 23, and from two full pages to two half-pages. By printing the form double-sided – and cutting off the bottom half of the page – it begins to look like the long-discussed postcard-size tax form.

However, fewer lines doesn't mean there's less information to report. Instead, it just means the Form 1040 only includes the items most likely to be used by taxpayers, such as wages, interest and retirement income. All other income items – including capital gains, business and rental income and more – must be reported on the [new Schedule 1](#). These items are then summed and reported on the Form 1040 as one item. Schedule 1 also is used to report any adjustments to gross income, such as retirement plan or health savings account contributions.

Schedule 1 is not the only new supplementary schedule used to reduce the number of line items on the Form 1040:

- [Schedule 2](#) – To report additional taxes such as any Alternative Minimum Tax (AMT) that is owed.
- [Schedule 3](#) – To report tax credits such as the Foreign Tax and Child Care Credits.
- [Schedule 4](#) – To report other taxes, such as Self-Employment Tax, and penalties like the one on early withdrawals from retirement plans.
- [Schedule 5](#) – To report estimated tax payments and other refundable credits

The Form 1040 may have become a shorter form, but for those who still choose to print and mail a hard copy of their tax return, it will likely include more pages due to these new schedules.

On the other hand, these attempts to simplify the form allowed the IRS to eliminate two other forms used by those with less complex tax situations – Form 1040EZ and Form 1040A. For 2018, all taxpayers will be filing the new Form 1040.

Other forms and schedules were changed as well, specifically to accommodate changes enacted under the TCJA. [Schedule A](#), used for itemized deductions, will have fewer lines thanks to the repeal of some deductions. The same

goes for [Form 6251](#), used to calculate the AMT. Taxpayers who like to compare their current return with last year's to make sure nothing was missed will need to be careful to compare specific items between the two years, not just line numbers.

CHANGES DUE TO THE TCJA

As for what's actually reported on the tax return, the impact of the TCJA will mean many important changes. In general, most taxpayers can expect to see a higher level of taxable income in 2018 as compared to 2017, assuming no material changes to their income and deductions for the year. This is because of new limits on – or even the loss of – various deductions taxpayers used in the past to reduce their taxable income. On the other hand, other changes will help to reduce the tax that's paid on that income, including new lower tax rates, expanded tax credits and a reduction in the impact of the AMT.

Some of the most common changes taxpayers may notice when preparing their returns include:

- A new \$10,000 cap on the deduction for state income and property taxes.
- The elimination of all miscellaneous deductions, including unreimbursed business expenses for employees, investment expenses and tax preparation fees, as well as the deduction for home equity interest.
- No longer available for 2018 is the deduction for personal exemptions, although many more families will qualify for the expanded child tax credit.
- The new tax brackets mean lower tax rates apply to nearly all ranges of income this year.
- Changes to the Alternative Minimum Tax mean only those with unusual types of income or deductions will be affected by this tax.

The tax withholding tables used by employers also were changed in early 2018. As a result, much of the tax cut under the TCJA already was received by taxpayers via lower withholding amounts throughout the year. With tax payments during 2018 lower, taxpayers should be ready for smaller tax refunds – or larger payments – than they might have otherwise expected.

QUALIFIED CHARITABLE DISTRIBUTIONS

Reporting Qualified Charitable Distributions (QCDs) on a tax return is an area that often causes confusion for taxpayers. QCDs are gifts made directly from an IRA to a charity, and they only are available to IRA owners who are at least age 70½ at the time of the gift. In those cases, the IRA distribution is not considered taxable income to the account owner. It also means the owner won't take a tax deduction like they would for other charitable gifts.

Where taxpayers get confused is when the brokerage firm or other entity that holds their IRA issues a Form 1099-R, reporting the QCD like they would any other IRA withdrawal. There also isn't any special code on the 1099-R to tell the IRS this was a QCD. Seeing this reported as taxable income to the IRS can be frustrating to the taxpayer.

However, taxpayers should understand that IRA custodians are required by the IRS to issue this form without any special coding, regardless of where the funds are ultimately delivered. The IRS doesn't want to make IRA custodians determine if the recipient of the gift is a qualified charity. Instead, that is the responsibility of the taxpayer.

If any portion of an IRA withdrawal should be treated as a QCD, the entire withdrawal should be reported on line 4a of the Form 1040. If any portion of the withdrawal was NOT sent to a charity and is instead taxable to the owner, that amount should be reported on line 4b and included in taxable income. Lastly, the taxpayer must write "QCD" in the space to the left of line 4b to explain to the IRS why there is a difference between the two amounts. Taxpayers will still need to receive a confirmation letter from the charity to document the gift, like they would for any other charitable contribution.

NONDEDUCTIBLE IRA CONTRIBUTIONS

Any taxpayer who has earned income – or has a spouse with earned income – is eligible to make a contribution to a Traditional IRA. In many cases, that IRA contribution is tax deductible, and those taxpayers report the contribution on their tax return as an adjustment to their income on the new Schedule 1.

Taxpayers with income that exceeds a threshold are not allowed to claim that adjustment, yet for a variety of reasons still choose to contribute to the IRA. That nondeductible contribution may not provide an immediate tax benefit, but at least it will provide tax-deferred growth until it's withdrawn later in life. Others may be taking advantage of the backdoor Roth contribution process and plan to convert that Traditional IRA to a Roth IRA. Regardless of the reason for the nondeductible contribution, there is still a requirement to report it on the tax return for the year it's made.

[Form 8606](#) is used to report an IRA contribution that is not tax-deductible. Why is it important to report this deduction? Because when the IRA owner begins to withdraw from the account during retirement, those nondeductible contributions can be withdrawn tax-free. They must be withdrawn on a pro-rata basis with any deductible contributions in the account, as well as the earnings on all contributions, but at least a portion of each IRA withdrawal will be tax-free. Without reporting those nondeductible contributions each year on Form 8606, the IRS would never know they were made and therefore wouldn't allow any portion of the withdrawal to avoid tax – essentially double-taxing those contributions.

Too often taxpayers assume that because the IRA contribution won't be deductible, there's no need to report it on their tax return, or to even tell their tax preparer about it. For those who have neglected to prepare Form 8606 in the past, the IRS will accept late-filed versions of the form. There is a \$50 penalty assessed for each form that is filed late, and the taxpayers must use the form for the year the contribution applies (rather than using the most current form to report older contributions). Prior-year tax forms can be found on the IRS website at <https://www.irs.gov/forms-pubs/prior-year/>.

ALTERNATIVE MINIMUM TAX CREDIT

Changes to the AMT system were among the most significant items included in the TCJA. The AMT had steadily grown since it was first implemented, to where roughly five million taxpayers paid this additional tax in 2017. It is predicted that could fall to as few as 200,000 in 2018.¹

The good news is that taxpayers who have been subject to the AMT in the past may have built up something called an AMT credit, which is a way to recover that extra tax that was paid in a prior year. However, that AMT credit could only be used in a year when the taxpayer was not otherwise subject to AMT. Many taxpayers who are subject to AMT in one year find they continue to be subject to it until they retire or their income situation changes. For some, it can be many years before they recover their credit. With the changes to AMT this year, many taxpayers will find they can now avoid the AMT and finally recover those tax credits.

Unfortunately, not all AMT that is paid can be recovered via the credit. AMT that is due to unusual items, such as stock option exercises or depreciation adjustments, can be recovered. If AMT is caused by state tax deductions or certain tax-exempt bonds, for example, that extra tax is not available as a credit. Calculating the available credit is done on [Form 8801](#), which can be a very daunting form to complete. This form is used to determine how much of the AMT paid in the prior year can be recovered as a credit in the future, and also how much of that credit can actually be used in a particular year.

Taxpayers who have paid AMT in the past should check their 2018 tax returns carefully to see if they qualify for an AMT credit. Tax preparers and home software packages are good at tracking this, but only if the right information is provided to begin with.

¹ The Tax Policy Center. "The Tax Policy Center's Briefing Book". Updated December 2018, page 179. https://www.taxpolicycenter.org/sites/default/files/briefing-book/bb_full_2018_1.pdf