



Tax help for  
reporters,  
freelance  
writers and  
photographers

Wolters Kluwer Tax & Accounting

*2017 Whole Ball of Tax*

*Tax Guide for Journalists*

By Mark Luscombe, JD, LL.M., CPA

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# Table of Contents

<b>Wolters Kluwer Tax &amp; Accounting: A Reporter's Resource</b>	<b>1</b>
For Assistance	1
<b>Introduction</b>	<b>3</b>
<b>What Is Your Employment Status?</b>	<b>4</b>
Weekend Writers and Hobbyists	4
Employee or Independent Contractor?	5
Freelance Writers, Editors and Photographers	6
Employees	8
<b>Professional Income</b>	<b>9</b>
Sales of Copyrighted Materials	9
Royalties	9
Prizes and Awards	9
Scholarships, Fellowships and Grants	10
Strike Benefits	10
Income of Foreign Correspondents and Others Living Abroad	11
Estimated Income Taxes	13
Social Security and Medicare Taxes	14
Medicare Contribution Taxes	15
<b>Deductible Expenses</b>	<b>16</b>
General Rules for Deductions	16
Car Expenses	17
Home Offices	20
Meals and Entertainment Expenses	23
Travel Expenses	25
Computers, Office Furniture and Other Equipment	29
Office Supplies	32
Home Telephones	32
Professional Journals and Dues	33
Union Dues	33
Other Expenses	33

<b>Records and Reimbursements</b>	<b>35</b>
Kinds of Evidence	35
How Long Must Records Be Kept?	36
Facts You Must Record	37
Shortcuts for Records	37
Expense Accounts and Reimbursements	39
<b>Pensions and Health Insurance</b>	<b>42</b>
Advantages of Retirement Plans	42
Plans for Employees	43
Plans for the Self-Employed	46
Retirement Credits	48
Health Insurance	49
<b>Tax Planning For Your Future</b>	<b>52</b>
A Delayed Tax Is Money Saved	52
Taxes and Your Heirs	54
<b>Returns and Audits</b>	<b>55</b>
Getting Professional Tax Help	55
Eligibility for Tax Relief	56
How to Handle an Audit	56
<b>Glossary of Tax Terms</b>	<b>59</b>
<b>2017 Tax Rates</b>	<b>70</b>
<b>2014 Average Itemized Deductions</b>	<b>71</b>

## *Wolters Kluwer Tax & Accounting: A Reporter's Resource*

For more than 100 years, Wolters Kluwer Tax & Accounting (formerly known as CCH) has been a leading provider of tax, accounting and audit information, software and services (CCHGroup.com). Five generations of professionals have relied on the company to keep current and compliant with the ever-changing tax and accounting law. In-house legal and accounting professionals cover developments for an extensive line of publications, software and online services used by accountants, lawyers, government officials and corporations, financial services specialists and small business owners. Reporters can depend on Wolters Kluwer Tax & Accounting for help in preparing their tax and financial planning stories. We provide timely assistance in these areas:

- Access to knowledgeable experts and analysts
- Research support
- Fact checking
- Reference materials
- Annual tax season resources

Wolters Kluwer Tax & Accounting can offer assistance on many topics, including:

### *Taxation*

- Federal taxes
- State taxes
- Tax legislation
- Small business taxation
- Tax planning, preparation
- Tax history
- Tax statistics
- International taxes, treaties

### *Financial Planning*

- Estate planning
- Wills and trusts
- Pensions
- IRAs
- Retirement
- Investments
- College savings funds
- Health plans

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Mark Luscombe, a CPA and attorney, is the principal federal tax analyst for Wolters Kluwer Tax & Accounting, tracking and analyzing legislation before Congress. Luscombe is the current chair of the Important Developments Subcommittee of the Partnership Committee of the American Bar Association Tax Section and regularly speaks on a wide range of tax topics. In addition, Luscombe co-authors a monthly tax strategies column for the respected professional publication *Accounting Today* and authors a monthly tax trends column for *Taxes — The Tax Magazine*<sup>®</sup>. Prior to joining Wolters Kluwer, he was in private practice for almost 20 years with several Chicago-area law firms where he specialized in taxation.

## *Introduction*

This is the 24<sup>th</sup> edition of the *Tax Guide for Journalists*, perhaps the most authoritative specialty tax reference available for reporters' and professional writers' personal use.

As is common in election years, 2016 passed without significant tax legislation. However, the Protecting Americans from Tax Hikes (PATH) Act of 2015, enacted on December 18, 2015, which made many regularly-expiring provisions permanent, also made a number of modifications to those provisions that were effective for the first time in 2016.

As a result of the Republican successes in the 2016 elections, 2017 promises to be a very significant year for tax legislation. It appears possible that fundamental tax reform can be achieved in 2017, with lower tax rates and elimination of many tax breaks.

One piece of legislation enacted in 2016, the 21<sup>st</sup> Century Cares Act, allows certain small businesses to use qualified small business health reimbursement arrangements without being subject to penalties under the Affordable Care Act.

As in previous years, there were also a number of modest inflation-related adjustments to the tax brackets and the various phaseout and deduction amounts.

The 2017 *Tax Guide for Journalists* was created to help you personally keep up with all these changes and take advantage of some opportunities. Even if you're writing about personal finance and taxes, it's always nice to have a reference that takes your specific profession and work environment into account.

If during the year you need assistance with stories that involve taxes, personal finance or any area of business law, please don't hesitate to contact Wolters Kluwer Tax & Accounting for help: **CCHMediaHelp@wolterskluwer.com**. Also, check out our Press Center (**CCHGroup.com/Press**) for timely tax and business law information, news, data and topical experts.

## *What Is Your Employment Status?*

To a large extent, your employment status determines the amount of time you'll need to spend on bookkeeping and taxes.

If you're lucky enough to be employed full time by a single employer who reimburses you for virtually all your business-related expenses, congratulations! At tax time, you may be able to get away with filing the simplest of tax forms (1040EZ or 1040A) — assuming, of course, that you don't have any complicated investments in your portfolio or that you're not married to someone who does.

But, if you want to claim some business-type expenses that aren't reimbursed, you'll need to spend a bit more time. Moreover, you'll have to file the federal "long form," affectionately known as Form 1040.

And, if you do any freelance work at all, you are the owner of a small business. (Online publications, and even some traditional print publications, seem increasingly to depend on freelancers.) You not only will have to file the long 1040 form, but you'll also have to complete a Schedule C (or the simpler C-EZ) for your business and probably a Schedule SE to pay Social Security and Medicare taxes. You may even have to pay estimated income taxes during the year.

### **Weekend Writers and Hobbyists**

If you do only a small amount of writing or photography or do a blog in addition to a main job in another field, it's possible that the IRS would classify you as a hobbyist working primarily for pleasure rather than as a professional journalist who is mainly seeking to earn income.

#### *Who is a professional?*

The IRS will presume that you're running a business, rather than merely dabbling in a hobby, if you had a net profit in three out of the last five years.

If you've had more than two years of red ink in the last five, your chances of being treated as a professional are slim. However, you might be able to convince the IRS to treat you as a professional if you spent significant time and effort at your work, if you conducted your affairs in an extremely business-like fashion, if you have made a profit at similar undertakings in the past or if there is normally a "start-up period" of negative profits in your line.



*What's so bad about hobbies?*

Being treated as a hobbyist certainly simplifies your tax return. You report your gross hobby income as “miscellaneous income” on your Form 1040. You pay federal income tax on your hobby income, but you don't have to pay FICA (Social Security and Medicare) taxes on the income.

But, the expenses you have in pursuing your hobby are deductible only to the extent of your hobby income — you can't claim a loss. Furthermore, the expenses are deductible only if you itemize deductions, and then only to the extent that the hobby expenses, combined with your other miscellaneous itemized deductions, are more than 2 percent of your adjusted gross income (AGI).

The main disadvantage of being classified as a hobbyist is clear: while you're taxed on all your income, you probably won't get credit for all your expenses.

**Employee or Independent Contractor?**

So, you've read through the last few paragraphs and you've determined that you're a professional, not a hobbyist. The next question is: Are you really self-employed or are you technically an employee?

You need to answer this question separately for each business in which you work. Journalism is an occupation in which it's not uncommon to be employed by one news organization and at the same time be a “stringer” or independent contractor for several others. You may be writing books or stories for a webzine as a sideline, and these also could be considered “self-employment.”

*A practical rule-of-thumb*

For most practical purposes, the decision as to whether you should be treated as an employee or as a self-employed independent contractor will be made by the organization that is paying you.

Generally speaking, if you receive a W-2 form at the end of the year, you are considered an employee by the business that gave it to you. If you receive a Form 1099-MISC or no form at all, you are considered an independent contractor. The IRS may, of course, examine the nature of your business relationship at any time and try to reclassify you if it disagrees.

*How does the IRS decide?*

The IRS uses rules known as the “common-law rules” to decide if you’re an employee or an independent contractor. Under these rules, you’re an employee if the person or business you work for has the right to control *what you do and how you do* your work. The employer must control not only the final results (e.g., a 400-word article on developments in managed health care), but also details about when, where and how your writing must be done.

In cases where the decision to be made is not obvious, you can be treated as self-employed if:

- The employer (or its previous owner or predecessor organization) has consistently treated you as an independent contractor since 1977 and has timely filed all tax returns on that basis;
- The employer has not treated anyone holding a substantially similar position as an employee since 1977 for employment tax purposes; and
- There is a reasonable basis for not treating you as an employee.

The “reasonable basis” referred to above can be met if it is the “long-standing recognized practice of a significant segment of the industry” to treat workers like you as self-employed. Also, the employer can rely on such things as court cases, IRS rulings and prior IRS audits to support the position that its workers are self-employed. How these rules apply was clarified and, to some extent, liberalized by 1996 legislation, but they still remain highly technical.

**Freelance Writers, Editors and Photographers**

Whether you freelance full time, moonlight as a stringer for an out-of-town paper or online site or have written the great American novel in your spare time, you should think of yourself as running a business. The IRS certainly does, and will tax you accordingly.

“Freelancer,” “independent contractor” and “sole proprietor” are all different ways of saying the same thing. Unless writing is your hobby (see page 4), you are a small business operator in the eyes of the law. So keep orderly records, write down absolutely every related expense you have and keep all your receipts if you expect any income at all from your writing.

One of the disadvantages of being self-employed is that clients are unlikely to reimburse you for the cash you shell out for supplies, equipment and overhead. Depending on the type of work you do, you might be reimbursed for some traveling or research expenses; unfortunately, this happens less frequently than one would hope. So you need to be able to document and claim your unreimbursed expenses on your tax return.

Moreover, as an independent contractor you must pay all the Social Security and Medicare taxes on your net self-employment income (that is, your gross income minus all deductible business expenses) instead of relying on an employer to pay half of it for you. If you expect to owe at least \$1,000 in all federal taxes combined, you'll also have to file and pay estimated income tax each quarter.

In recognition of these facts, the IRS does give self-employed people a break when it comes to deducting business expenses.

#### *Claim expenses on Schedule C*

If you're self-employed, all expenses that apply to your business can be deducted on Schedule C (or the simplified C-EZ) of your federal income tax return. These deductions have a real impact in reducing your income tax, as well as your Social Security and Medicare taxes. You don't need to itemize your deductions in order to claim every dollar of your business expenses.

In contrast, a staff reporter who is treated as an employee would be able to deduct only those unreimbursed expenses that exceed 2 percent of his or her adjusted gross income, and even then only if the reporter is able to itemize deductions. Moreover, itemized deductions don't reduce the Social Security and Medicare taxes the reporter has to pay.

It follows that those who are self-employed are in a better position to take advantage of all their allowable deductions.

One note, as freelancers you will need to file only one Schedule C each year, regardless of the number of clients you serve and regardless of the different types of material you may write. After all, one of the hallmarks of an independent contractor is working for a number of different businesses.

However, if you supplement your earnings as a journalist by selling real estate, moonlighting as a carpenter or running some other completely different type of operation, you will need a separate Schedule C form for each line of business.

## Employees

If you're considered an employee (full-time or part-time) by an organization for which you work, the way that you write off the expenses pertaining to your job depends on whether your employer reimburses you for those expenses and, if so, what type of reimbursement plan the employer uses.

Generally, you'll get the full benefit of all your allowable deductions if they are reimbursed by your employer and the employer uses what is known as an "accountable plan."

This is a type of plan that requires you to report and document your expenses for your employer and to return any expense allowance amount over and above the expenses you have proven. Your employer then subtracts the reimbursements from your taxable income when filling out your annual W-2 form. The upshot is that you pay no tax on the amount of the reimbursements because it is canceled by the expenses.

### *Claim unreimbursed expenses on Form 2106*

If you have job expenses that are not reimbursed by your employer, or if your employer does not use an accountable plan, you must claim these expenses on Form 2106, *Employee Business Expenses*. (You may be able to use the simpler Form 2106-EZ if you aren't reimbursed for *any* expenses and if you use the standard mileage rate for any car expenses you incur.) Then, the total amount of the expenses from Form 2106 or 2106-EZ is transferred to Form 1040, Schedule A, *Itemized Deductions*, and included in the section for "Job Expenses and Most Other Miscellaneous Deductions."

Unfortunately, Schedule A requires you to subtract 2 percent of your adjusted gross income from your miscellaneous itemized deductions, and only the remainder is counted in your favor. What's more, if you can't or don't itemize your deductions, you'll lose the tax benefit of your job expenses entirely.

As you can see, it becomes very important to keep track of your expenses so that your allowable deductions will be as large as possible. Sometimes a few extra dollars of expenses will make the difference when you're deciding whether it's worth the trouble to itemize in a given year.

## *Professional Income*

As a professional reporter, editor, photojournalist, blogger or freelance writer, you might be paid a salary, an hourly rate, a space rate on the basis of words, lines or pages, or a per-story rate. You may receive advances or partial payment for a proposed book or article, or you may receive “kill” fees for articles or stories that have been rejected after they were completed. And, if you have a book, play or other copyrighted material published, you may receive royalties for years after the date of publication.

Regardless of the various names placed on the fees you receive, they are all ordinary, taxable income to you — that is, they are taxed at the ordinary income tax rates rather than the capital gain rate.

The following pages discuss several types of income that are of particular interest to journalists.

### **Sales of Copyrighted Materials**

Although the right to exploit a copyright is usually considered a depreciable “capital asset” in the hands of a publisher, it is an “ordinary asset” in the hands of the creator of the work.

So, the sale of a book or article you wrote or a picture you shot is treated as ordinary income to you, rather than as capital gains, regardless of the fact that the sale was essentially a transfer of some or all of your copyright interest in the work. Since 2006, an exception in the tax law permits songwriters to treat the copyright to a catalog of songs as a capital asset.

### **Royalties**

Royalties on books, plays, photographs or other copyrighted material are considered taxable ordinary income to you.

If you're in business as a self-employed writer or photographer, you report royalties you receive on the Schedule C you file for your business. Other people (for example, those who purchase or inherit a copyright on material they did not create) report royalties on Schedule E, *Supplemental Income and Loss*.

### **Prizes and Awards**

If you win a Pulitzer Prize, a Nobel Prize or some other award of money or property in recognition of your journalistic or literary achievements, the value of the award is fully taxable.

There is a very limited exception to this rule in the case of awards for literary, educational, scientific, civic, religious or charitable achievement if (1) you were selected for the award without having taken any action to enter the running, (2) you aren't required to perform future services as a condition of receiving the award and (3) you don't use the award, but transfer it directly to a charitable organization or a government body.

Certain achievement awards given to an employee by his or her employer are nontaxable, but these are generally limited to length-of-service or safety-achievement awards.

### **Scholarships, Fellowships and Grants**

In some cases, scholarships, fellowships and grants awarded to journalists or writers are nontaxable.

The main question is: Are you a "degree candidate"? The IRS definition of degree candidate is more generous than you might expect. You qualify if:

- You attend a primary or secondary (high) school or are pursuing a degree at a college or university; or
- You attend an educational institution that is authorized to give full credit towards a bachelor's or higher degree, or to provide a program of training to prepare students for gainful employment in a recognized occupation.

If you are a degree candidate, the amount of a scholarship or fellowship that is spent on tuition, fees, books, supplies and equipment is not taxable. However, if any part of the grant represents payment for your teaching, research or other services, that part is taxable.

So, if you receive a grant to take a sabbatical from your regular job and write a novel, you'll have to pay federal income tax on the amount you receive.

### **Strike Benefits**

If you're a member of a union that goes on strike and you are lucky enough to receive some form of strike benefits, the payments are generally treated as taxable income.

An exception applies to benefits paid to both union and nonunion members in the form of food or rent, based on the recipients' financial needs. In these narrow circumstances, the payments are a nontaxable gift.

**Income of Foreign Correspondents and Others Living Abroad**

If you live and work abroad, or if you receive income that was earned abroad, but you are a U.S. citizen or resident alien, you are still required to file a U.S. income tax return and to make quarterly estimated tax payments under the usual rules.

An exception is allowed for persons who receive very minimal income, just as for low-income earners in the States.

*Foreign earned income exclusion*

For 2015, you may be able to exclude the first \$100,800 you earn abroad from personal services (the limit rises to \$101,300 for 2016) if you meet one of the following two tests:

- The “bona fide residence test,” which requires you to establish residence in one or more foreign countries for an uninterrupted period that includes a full tax year or
- The “physical presence test,” which requires that your main place of business be in a foreign country and that you have been present in a foreign country or countries for 330 days out of any consecutive 12-month period.

These time limits can be waived if you fail to meet either of the tests because you were forced to flee the foreign country due to civil unrest, war or certain other adverse conditions recognized by the IRS.

*Foreign housing exclusion*

If you meet either the “bona fide residence test” or the “physical presence test,” you may also be able to exclude a portion of housing expenses paid or reimbursed by your employer. If you’re self-employed, certain housing expenses you paid could qualify for the exclusion.

Under a law change in 2006, even though you qualify for the foreign earned income exclusion or foreign housing exclusion, the excluded amounts must be taken into account in determining the tax rate that applies to your non-excluded income.

*Tax forms needed*

If you’re eligible to exclude any foreign earned income or housing expenses under the rules discussed above, you must generally file Form 2555, *Foreign Earned Income*, with your regular Form 1040, unless you have 2016 income

of \$101,300 or less and are eligible to file the simplified Form 2555-EZ. One of these forms must be filed even if all of your foreign income is excluded and you don't owe any tax. In addition to paying tax on world-wide income, you may also be required to report foreign assets you own on Form 8938.

#### *Deduction or credit for foreign income tax paid*

If you can't exclude all your income under either the foreign earned income exclusion or the housing exclusion, you can still claim a deduction or a credit for the amount of income tax you paid to a foreign government. The deduction would be claimed as an itemized deduction on Schedule A of your 1040 form; the credit would be claimed on a special form, Form 1116, *Foreign Tax Credit*.

Whether claiming the deduction or claiming the credit would be more advantageous depends on your individual situation; you may have to figure your tax both ways (or have your tax professional do this) before you can decide.

Also, be aware that accredited correspondents working overseas in a combat zone may qualify for additional time to file tax returns, pay taxes owed or take other actions with respect to taxes. (See page 56.)

#### *Social Security and Medicare taxes*

The exclusions, deduction and credit discussed above apply for federal income tax purposes. Unfortunately, they don't apply for Social Security and Medicare tax purposes. You may have to pay these taxes regardless of where you worked, unless the U.S. government has signed a formal agreement with the government of the country in which you work.

Generally, these agreements provide that you will only have to pay Social Security-type taxes to one country, and they specify which country will eventually pay your benefits. If no such agreement is in effect for your country, you may end up paying taxes to both the United States and the foreign government.

For more details on these rules, as well as other information pertaining to foreign correspondents, consult your employer or tax advisor or see Chapter 24 in Wolters Kluwer's *2017 U.S. Master Tax Guide*®. You can also contact the nearest U.S. Embassy or Consulate or write to the IRS: Internal Revenue Service, International Accounts, Philadelphia, PA 19255-0725.



### **Estimated Income Taxes**

If you're fully or partially self-employed, you may have to make quarterly estimated income tax payments.

The IRS wants to get most of its money ahead of time over the course of the year, rather than all at once on April 15. If you don't prepay enough of your federal income taxes through employer withholding or your own quarterly estimated tax payments, you'll pay a penalty to the IRS.

#### *Employees*

Generally speaking, if you're employed, your employer will withhold federal income tax from your pay based on the amount of your salary and the number of withholding exemptions you claim.

If you have large amounts of income from freelancing or other sources such as interest and dividends, you can ask your employer to withhold more tax. Alternatively, you can make estimated tax payments each quarter, as described below, to be sure you're prepaying enough to avoid penalties.

#### *Self-employed journalists*

If you are totally self-employed, or you don't wish to have your employer withhold extra amounts from your pay to cover tax due on outside income, you'll need to make estimated tax payments.

Your payments should be calculated so that they, plus any withholding, add up to the least of these three amounts:

1. The amount of tax you expect to owe for this year, minus \$1,000;
2. 90 percent of the tax you expect to owe for this year; or
3. 100 percent of the tax you owed last year. However, if your adjusted gross income last year was over \$150,000 (\$75,000 for marrieds filing separately), you must substitute 110 percent of the tax you owed last year when paying estimated tax in 2017.

The total amount of estimated tax due for the year is normally divided into four payments, due on April 15, June 15 and September 15 of the current year, and January 15 of the following year. A check for any remaining tax due for the year must be enclosed with your income tax return and paid by April 15 of the following year.

These rules apply to federal income tax. You may also have to pay estimated state or local income taxes, so check with your state tax department.

### **Social Security and Medicare Taxes**

Whether you're an employee, self-employed or both, you'll have to pay some form of Social Security and Medicare taxes on your earnings. For 2016, you pay Social Security tax on the first \$118,500 (\$127,200 in 2017) you earn in the year, and you pay Medicare tax on all of your earnings, regardless of the amount.

#### *Employees*

If you're an employee, half of the Social Security and Medicare taxes will be withheld from your salary. The rate is normally 7.65 percent of the first \$118,500 for 2016, and 1.45 percent of any earnings above that amount. The employer has to match these amounts out of its own funds.

#### *Self-employed journalists*

If your net self-employment earnings — that is, your gross income minus any deductible business expenses — total \$400 or more in the year, you must pay Social Security and Medicare taxes in the form of the Self-Employment Contributions Act (SECA) tax. You must file a self-employment tax return (Schedule SE) along with your regular individual income tax Form 1040.

Moreover, you'll have to estimate the amount of SECA tax you expect to owe during the year and include one-fourth of this amount in each of the quarterly estimated income tax payments you make.

The normal 15.3-percent rate of SECA tax applies on net income up to \$118,500 and 2.9 percent on all income above \$118,500 for 2016. (This threshold is increased annually for inflation.) However, the IRS also gives you two small tax breaks to ensure that the amount of SECA tax you pay is the same as the amount that would be paid on your behalf if you were an employee:

- First, in order to figure out the amount of your earnings that is subject to the SECA tax, you treat one-half of the normal tax (at the 15.3-percent rate) as a deductible expense. You pay SECA only on the earnings remaining after claiming this deduction and your other allowable business expenses.

- Second, after you compute the amount of SECA tax on the Schedule SE, you can deduct one-half of the normal amount of the tax (at the 15.3-percent rate) on the front of your income tax return (Form 1040).

These calculations are not as complicated as they sound. The instructions on the Schedule SE will walk you through the math.

### **Medicare Contribution Taxes**

Starting in 2013, two additional Medicare taxes become effective as part of health care reform legislation enacted in 2010. An additional 0.9-percent Medicare contribution tax applies to earned income in excess of \$200,000 for single filers and \$250,000 for joint filers. In addition, a new 3.8-percent net investment income tax applies to the lesser of net investment income or modified adjusted gross income in excess of \$200,000 for single filers or \$250,000 for joint filers. Net investment income includes such items as interest, dividends, rents, royalties, net gain from the sale of property, and net gain from passive investment activities.

## *Deductible Expenses*

Whether you're an employee, self-employed or both, you may be able to deduct car, computer, office, telephone, travel and various other expenses you have while working on your stories or otherwise conducting your business.

Claiming as many deductions as the law allows will lower your taxable income and, as a result, your tax bill will be lower. If you know the rules that apply to deductions in your profession, you can arrange your work routines to take full advantage of the items that are deductible, and avoid the ones that aren't, wherever possible.

In most cases, the rules about deductions apply to employees as well as self-employed people. The only major difference is in the way the deductions are reported to the IRS (see pages 5–8).

### **General Rules for Deductions**

An expense must be both “ordinary” and “necessary” to the business you're in before it can be deducted. That means it must be common and accepted in your line of work, and it must be appropriate or helpful to the work you do. It doesn't have to be absolutely indispensable to your work to be deductible.

As a general principle, you can't deduct amounts spent for personal or family reasons. Sometimes this line may be difficult to draw, especially if you're self-employed. The IRS has been known to come down hard on those who don't keep their personal expenses and business expenses separate and who attempt to deduct personal living expenses from their business income.

**Tax Tip:** The IRS is more easily convinced that you properly separated your business expenses from your personal living expenses if you maintain a separate business checking account. Any monthly service, ATM or per-check fees on such an account would be deductible.

Another rule to keep in mind is that illegal payments (e.g., bribes and kickbacks) and payments of fines or penalties (e.g., parking or traffic tickets) are never deductible.

## Car Expenses

If you frequently use your car to get to the scene of a breaking story, to meet with sources or to do research for your writing projects, it's likely that you'll be able to deduct many of the expenses of operating your car. In fact, your car expenses could be your largest deduction in terms of dollars.

However, you can't deduct expenses for your personal use of the car, or for commuting from your home to your office or regular workplace.

In order to claim a deduction for any of your car expenses, you'll have to keep records showing the mileage you drive for business, personal and commuting purposes over the course of the year. It's strongly suggested that you keep written records. See the following pages for more information on the form these records should take.

### *What car usage is deductible?*

Basically, the cost of traveling from your home to your office (or another regular place of business) and back again is considered "commuting" and is not deductible.

What *is* deductible is the cost of getting from one "business location" to another. So, for example, if you go to the office to check in with your editor in the morning before going to city hall for a press conference, the cost of getting from your office to city hall would be deductible, as would the cost of getting back to your office after the conference.

**Tax Tip:** If your first trip of the day is to a destination that is not one of your regular places of business, you can deduct it. So, you may want to arrange a meeting with a source or a stop to check background information as your first stop of the day, before you get to the office, and as the last stop at night on your way home. That way, you can eliminate your nondeductible commute for the day entirely.

A "business location" can be any place you need to go to investigate, report, photograph or research a story. It can also be a professional association meeting, a lunch to confer with a source or another reporter about a story, an office supply store or the bank at which you're about to deposit money in your business account.

If your main place of business is your home, you can deduct the cost of trips from home to any business location. (See the discussion of home offices on pages 20–23.) However, if you have a regular office away from home, the fact that you use your home as a secondary office will not transform your commuting expenses into deductible car expenses.

*How much can you deduct?*

There are two basic ways of figuring out your car expense deduction: the standard mileage rate and the actual cost method. Usually, you can choose whichever method gives you the greater deduction, although there are some restrictions.

**Standard mileage rate.** This is generally the easiest method to use. You simply keep track of your business, personal and commuting mileage during the year and multiply your number of business miles by the special rate set by the government (which was 54 cents for 2016 and 53.5 cents for 2017). To this amount, you can add the total cost of parking and tolls you paid while driving for business purposes.

The standard mileage rate is intended to take into account all the operating costs of your car, including depreciation. It does not include interest on a car loan. If you're self-employed, you can deduct any interest you paid during the year, multiplied by the percentage of business use of the car, on your Schedule C or C-EZ. However, if you're an employee, the interest is not deductible at all because it is considered a personal expense.

The only records you need to keep are your mileage records showing your beginning and ending odometer readings for each trip, a brief description of the reason for each trip, a note about any parking and toll expenses and, if you're self-employed, records showing any interest you paid on a car loan during the year.

One restriction to note is that the IRS won't let you use the standard mileage rate unless you used it in the very first year you used that particular car for business. This is a major catch because the actual cost method is usually better for a new car than the standard mileage rate.

You can use the standard mileage rate for a leased car, not just a car you own, provided that you continue to use it for the entire term of the lease.

**Actual cost method.** The actual cost method is more complicated to use, but may result in a larger deduction. To use this method, you start with the same records that you would need for the standard mileage rate.

You must also keep track of all your actual car expenses for the year, such as:

- Auto club memberships
- Batteries
- Depreciation
- Garage rent
- Gas
- Insurance
- Lubrication and oil
- Registration and licensing fees
- Repairs (parts, labor, tax)
- Supplies, such as antifreeze
- Tires lasting less than a year
- Washing and waxing expenses

At the end of the year, you compare the number of business miles driven with your total mileage on the car to arrive at the percentage of car use that was business-related. Then you multiply this percentage by your total actual car expenses to arrive at the dollar amount of your deduction.

For example, if your mileage records show that 25 percent of your car use was for business, you'd total up your car expenses for the year and multiply by 25 percent. To this amount you could add the whole amount of parking fees and tolls you paid during trips made for professional reasons.

**Depreciation.** One of the larger components of the actual cost method is depreciation. Depreciation is basically a way of writing off the cost of a piece of business property over the number of years that theoretically equals its useful life (but often is set to give or negate a perceived tax advantage).

For a car placed in service in 2016, there is a standard depreciation limit of \$3,160 (\$11,160 if qualified for 50-percent bonus depreciation) in the first year, \$5,100 in the second year, \$3,050 in the third year and \$1,875 in any subsequent year until the entire business percentage of the car's price is written off (these amounts can change each year). There are separate limits for light trucks and vans. Vehicles weighing over 6,000 pounds are not subject to these depreciation limits. If you use your car less than 100 percent for business, you have to multiply the dollar limits by the percentage of car use that was for business.

The dollar limits apply to cars that are used at least 50 percent for business. If your car doesn't fall into this category, your depreciation

deduction might be even lower. For instructions on computing depreciation, consult your tax professional or get the IRS's free booklet *How to Depreciate Property*, Publication 946, by calling **1-800-TAX-FORM** or going to the IRS website at [www.irs.gov](http://www.irs.gov).

#### *Other local transportation*

You can also deduct the cost of bus tokens, train or ferry tickets, cab fare (including tips), etc., when you use these forms of transportation to get from one business destination to another. As with cars, your commuting expenses are nondeductible. See page 17 for a discussion of the kinds of trips that count towards your deduction.

If you use alternate transportation, you should keep receipts for your expenditures wherever possible. Otherwise, you should jot down the date, amount and reason for each trip.

#### **Home Offices**

If you use part of your home for writing or other business activities, consider the possibility of deducting some of the expenses of your home.

Partly because the IRS believes that the home office deduction has been subject to abuse in the past, the rules for claiming it historically have been rather strict. Since 1999, the requirements have been significantly easier to meet. In 2014, an even more simplified method became available: instead of using actual expenses, you can deduct five dollars per square foot for up to 300 square feet of qualifying home office space.

It should also be said at the outset that, in the IRS's view, the home office deduction refers to expenses like depreciation, mortgage interest or rent, property taxes, insurance, utilities and home repairs. It does not include telephone charges, office equipment or supplies — *these expenses may be deductible even if you don't meet the requirements for the home office deduction described below. See pages 29–34 regarding these "direct expenses."*

#### *Home office requirements*

To deduct part of the expense of a home, you must use a specific part of it *exclusively and regularly* for work in your profession or business. The "office" doesn't have to be a conventional office — it can be a darkroom or studio if you're a photographer, or it can be just a small part of a room.

"Regularly" means not just occasionally.



“Exclusively” means only for business. You can’t use the home office for any personal, family or investment activities. Having a television in your home office is ordinarily evidence of personal use — with a possible exception for those who can show a professional need to keep up with the news via broadcast or cable media. If you keep your computer in your home office you can’t let your kids (or yourself) play video games on it, nor can you use it to write personal letters or balance your family checkbook.

Also, you must meet one of the following requirements:

1. The business part of the home must be your principal place of business; or
2. You must use the space to personally meet customers or clients (phone calls don’t count); or
3. If the office is a separate structure that isn’t attached to your residence, it merely has to be used in your trade or business.

You meet the principal place of business test if your home is the only fixed place where you handle the management and administrative duties of the business. This should make it much easier for people to claim the deduction, especially those who do a lot of interviews or research outside the office, but return there to do their paperwork.

If you are an employee, you have another hurdle to clear. You must be using your home office for the convenience of the employer, rather than your own convenience. If your employer provides you with a desk at its headquarters, you’re probably ineligible for the home office deduction because your home wouldn’t be considered your main place of business.

**Tax Tip:** You can use the same home office for more than one type of business activity. For example, if you’re employed as a staff reporter and you also do some freelance writing, you can do both kinds of work in your office. However, you must satisfy all the IRS tests with respect to each activity. Otherwise, you’ll lose the entire deduction.

*Which expenses are deductible?*

If you meet the tests described above, you can deduct the “business portion” of the following:

- Real estate taxes
- Insurance
- Mortgage interest and depreciation, or rent if you don’t own the home
- Light, heat and trash collection
- Water (if used in your line of work)
- Cleaning service
- Repairs and decorating
- Security system
- Casualty losses

The business portion is generally a percentage that equals the floor space of the home office divided by the total floor space of the home. This method almost always is used to find the business portion of your mortgage interest, real estate taxes, heat and insurance.

However, your circumstances can dictate a different method of finding the business portion of certain types of expenses. For example, if your computer uses a lot of electricity, the business portion of your electric bill could be higher.

Similarly, if you do decorating or repairs that affect only your office, you can deduct the entire cost. Conversely, if the repairs affect only non-office parts of the home or only the outside of the building, you can’t deduct them at all.

**Depreciation.** If you own the home, you can recover part of the cost of purchasing the home through depreciation.

To figure your depreciation deduction, you must first determine the “tax basis” of your home. This is normally its purchase price reduced by (a) the cost of the land it sits on, (b) gain on the sale of a prior home that was not taxed or qualified for the exclusion on the sale of a principal residence, and (c) any earlier deductions for depreciation or casualty losses. Improvements to the home are then added to this amount. This is not the tax basis of your home office, however. To arrive at *that*, you must figure the percentage of your home’s total floor space that is your office. Multiply this percentage by the tax basis of your home to arrive at the tax basis of your home office.

Then, each year, the total amount to be depreciated is multiplied by a fraction determined by the IRS, based on the month and year you began using the office. Your tax professional can help you with this.

#### *Limit on home office deductions*

With most expenses incurred by journalists, if you have more expenses than income, you can claim a loss for the year. This loss could be deducted against any other ordinary income you have (such as interest, dividends or earnings from another job or business). If you're married and file jointly, you can even deduct it against your spouse's income.

Not so with the home office deduction. You may claim it only to the extent that you have any business profits left after deducting all your other allowable expenses.

If this limit prevents you from taking part of your home office deduction, the IRS will let you "carry it over" and take it in a future year.

#### *Claiming the deduction*

As with your other professional or business expenses, the way in which you claim your home office deduction depends on your employment status.

If you are self-employed, you must fill out a special form to claim the home office deduction. You must complete Form 8829, *Expenses for Business Use of Your Home*, and then transfer the total to your Schedule C. (Schedule C-EZ can't be used if you're claiming this deduction.)

If you're an employee, you don't have to file a Form 8829. Your unreimbursed home office deductions would be claimed on Form 2106, along with any other unreimbursed business expenses you have. Then, the total of these expenses would be combined with your miscellaneous itemized deductions on Schedule A of your individual income tax return (Form 1040). As mentioned above, you can deduct only the portion of the miscellaneous deductions that is higher than 2 percent of your adjusted gross income.

### **Meals and Entertainment Expenses**

If you make it a practice to take people you're interviewing out for lunch or drinks, you may be able to deduct half of your restaurant or bar bills. However, be aware that the IRS casts a skeptical eye over these kinds of deductions. There are a host of rules you must know and follow. Even if you

follow the rules to the letter, you can deduct only 50 percent of your meal and entertainment expenses.

In order to count towards your deduction, a business meal or entertainment event must be one at which you actively conducted business (e.g., you interviewed a source or you discussed a possible freelance assignment with an editor). Or it must be one that directly precedes or follows a substantial business discussion. A substantial business discussion can be a meeting or convention sponsored by a business or professional organization.

If these tests are met, you can deduct half of the costs of your own meal or entertainment as well as half of the costs for your guests.

What constitutes “entertainment” depends partly on your line of work. For example, if you write theater reviews and you aren’t reimbursed for the cost of tickets, these tickets would not be considered “entertainment” in your case. You could deduct 100 percent of the cost rather than just 50 percent.

**“Working lunches.”** If all the people attending a lunch meeting are coworkers, the cost of the meal is not deductible. The expenses don’t qualify as “necessary” and would be considered nondeductible personal expenses.

**Entertaining at home.** If you invite clients or interview subjects to your home to advance your business, the additional expenses you have because of the guests can be considered entertainment expenses. So, you could deduct the cost of food, drinks, catering, cleaning and flowers, but not your time in arranging or preparing the entertainment.

#### *Keeping records*

Keep documentary evidence such as a receipt, canceled check or credit card slip, for any expense of \$75 or more. If the expense is less than \$75, you can save the documentary evidence, or simply record the necessary information in an expense account book. In any case, you need to retain records showing the amounts, dates, locations, people entertained and the business purpose of the entertainment.

If you didn’t conduct business during the meal or entertainment, but it took place directly before or after a business discussion, jot down the date, place and duration of the business discussion. Also record the nature of

the discussion and the business reason for the entertainment, as well as the identity of the people who participated in both the business discussion and the entertainment.

For most journalists, keeping good tax records shouldn't be too difficult. If you're already in the habit of carefully documenting your source materials for stories, you're probably already writing down most of the information that the IRS wants you to save.

For more information on records, see pages 35–41.

### **Travel Expenses**

Whether you travel regularly or only rarely on assignment, it pays to know the rules for deducting travel expenses. Often you can combine a vacation with a business trip and still deduct many of your expenses, particularly if you're traveling within the United States.

Like all business expenses, the travel must be “ordinary and necessary” for your line of work in order to be deductible. Any lavish or extravagant expenses are not allowed.

#### *Types of expenses*

Some types of traveling expenses are always deductible, whether you're away from home overnight or just taking a day trip, as long as the expenses are reasonable and helpful to your work:

Airplane, bus or train tickets

- Baggage or shipping charges
- Telephone call charges
- Car operating expenses (see pages 17–20)
- Car rental expenses
- Fax machine charges
- Meals and entertainment (subject to the 50 percent rule — see pages 23–24)
- Passport fees
- Taxi and limousine fares
- Tips pertaining to any of the above

However, other types of expenses are deductible only if you are considered to be “traveling” on business under the definition described below:

- Dry cleaning or laundry charges
- Lodging
- Tips pertaining to any of the above

*Definition of “traveling”*

You’re considered to be “traveling,” and, therefore, eligible to deduct all the expenses described above, if you are away from your “tax home” for a long enough period of time.

As a rule, your “tax home” is the entire city or general area where your main place of business is located.

You are considered to be traveling if your job or business requires you to be away from your tax home for significantly longer than an ordinary day’s work, and you need to get sleep or rest to meet the demands of your work while you’re away. You don’t necessarily have to spend a whole night at your travel destination, though — a short rest stop in a hotel will qualify.

*Conventions and seminar expenses*

You usually can deduct the cost of attending a professional seminar or convention. The deductibility of these costs turns on whether there is a strong enough relationship between your profession and your attendance at the convention. In general, if you will benefit or advance the interests of your business by going, the expenses are deductible.

However, if you go to a convention for investment advice or for political, social or other purposes unrelated to your business, the expenses are not deductible. (This would not apply, of course, to conventions you are covering or photographing for a story.)

Even if attendance at the convention *is* related to your work, you usually can’t deduct expenses for your family, or for extra personal expenses you have while attending the convention (e.g., sightseeing trips).

**Foreign conventions.** Conventions held anywhere in North America that meet the tests described above are deductible. The IRS’s definition of “North America” includes all of the U.S. territories (Puerto Rico, the U.S. Virgin Islands, Guam and the Northern Mariana Islands), Canada, Mexico and much of the Caribbean. U.S. cruise ships qualify for a limited deduction of up to \$2,000 per year if (1) all ports are in the U.S. or U.S. possessions, (2) you establish that the convention is directly related to your trade or business and (3) you include specified information about the cruise and programs offered with your return.

If the convention is held outside this area, the rules are somewhat stricter. If you’re writing about the convention, it would be deductible. Otherwise,

it's deductible if it is a convention or meeting that is directly related to your profession or business, *and* it was as reasonable to hold the meeting outside North America as within it (for example, a meeting of an international press organization).

### *Combining business and personal travel*

The rules described above apply when you're on a trip that is entirely for business. If you take time out from your business trip for sightseeing or for socializing with nonbusiness associates, or if you tack on days of personal travel to your business trip, there is an additional set of rules for you to consider.

**Traveling companions.** You can bring your spouse (or another traveling companion) along on a business trip and still deduct the expenses for your own travel. But you can't deduct expenses for your companion unless he or she is also an employee traveling on business.

**Tax Tip:** The nondeductible portion of the expense is the difference between what you would have paid if traveling alone and what you actually paid. So, if the price of a single hotel room is \$80 but the price of a double is \$100, you can deduct \$80 rather than just half of \$100.

**Travel within the U.S.** When you combine personal travel with a business trip in the U.S., the key question to be answered is: was the trip mainly for business or personal reasons? The answer depends on the circumstances, but the main factor is the amount of time you spent on business activities versus personal activities.

If you take a trip *mainly for business or professional reasons*, you can deduct the traveling expenses of getting to and from your business destination. The expenses you can't deduct are the ones that are specifically for nonbusiness activities like sightseeing, for extra vacation days tacked on to the trip or for nonbusiness side trips.

If you take a trip that is *mainly for personal reasons* but includes some work activities, you can't deduct your transportation expenses, but you *can* deduct the costs that pertained specifically to your work.

**Foreign travel.** The rules for allocating foreign travel expenses between the personal and business categories are more restrictive. Still, it can pay to tack on some personal vacation time when you have a professional reason for taking a trip abroad.

The rules for traveling expenses described above apply generally to foreign travel as well. If you spend money on personal pursuits, those amounts are nondeductible, just as they would be if you were traveling in the U.S.

The chief difference with foreign travel is this: even if your trip was primarily for business, you may have to treat some of your airfare or other transportation costs as nondeductible personal expenses, even though you would have had to pay those amounts whether or not you spent any time on personal activities. The allocation of transportation expenses between the “business” and “personal” categories depends on the relative number of days you spent on each.

No such allocation is required, and all your transportation expenses are deductible, if:

- The foreign trip lasts less than seven consecutive days, counting the day of return, but not counting the day of departure;
- The time spent on personal pursuits is less than 25 percent of the total time away from home;
- You have no substantial control over arranging the trip; or
- You can establish that a personal vacation was not a major consideration in arranging the trip.

#### *Keeping records*

To claim a deduction for travel expenses, you have to keep rather detailed records showing:

- The amount of each separate expense for things like transportation, meals and lodging. (For small incidental expenses you can combine all similar costs in a single day. For example, you could record the cost of all taxi fares in a single day, all phone calls, all baggage charges, etc.);
- The date of departure and return for each trip and the number of days spent on business for each trip;



- The name of the city or town visited; and
- The business reason for the travel or the business benefits expected to be achieved.

Also, you need to save your receipts for all lodging expenses and for any other expense of \$75 or more. For more on records, see pages 35–41.

### **Computers, Office Furniture and Other Equipment**

Whether or not you are eligible to take the home office deduction, you may well gain some tax benefits from furniture and equipment that you use for your work as a journalist, photographer, blogger or freelance writer.

The equipment must be “ordinary and necessary” to your work, as defined on page 16. However, you don’t have to use the equipment exclusively for your business. For example, if you have a four-drawer file cabinet and you keep your story clips in one drawer, with personal records in the other three, you can probably claim a depreciation deduction for one-fourth of the cost of the file cabinet.

Similarly, if you purchase a computer and use it 75 percent of the time for job-related tasks and 25 percent of the time for personal tasks, you can probably depreciate three-fourths of the cost of the computer.

#### *First-year write-off*

If you purchase new or used equipment for business purposes, you can choose to deduct all or part of the cost in the first year under a special first-year write-off provision (also known as the Section 179 election because you elect the first-year write-off under Section 179 of the Internal Revenue Code).

The total amount of property you can write off this way in a single year can’t be more than \$500,000 (or your taxable income) in 2016 (\$510,000 for 2017). The expensing limit starts to phase down when the cost of a qualified property placed in service exceeds \$2,010,000 in 2016 (\$2,030,000 in 2017).

There is a downside to claiming this deduction. If your business use of the property drops below 51 percent in a later year, you may have to “give back” some of the first-year deduction amount you already claimed. Or, if you sell or get rid of the item before the end of its depreciation period (see below), you may have a taxable ordinary gain rather than a capital gain.

There is an additional first-year bonus depreciation available for 50 percent of the amount of certain property as an economic stimulus measure. After the Section 179 write-off, any remaining qualifying new equipment purchases can have more of the purchase price deducted in the first year, in addition to normal depreciation on the balance. The bonus depreciation percentage starts to phase down in 2018.

**Special rules for cars.** Most journalists would not be affected by the \$500,000 limit on purchases of equipment (though photographers might) to use in their profession. In most cases, this would cover equipment purchases for the year, including a car.

However, the IRS has devised a special, much lower dollar limit for the amount of the first-year write-off you can claim on a car weighing 6,000 pounds or less. For 2016, the limit was \$3,160. If the vehicle is used more than 50 percent for business and qualifies for 50 percent first-year bonus depreciation, the 2016 limit was \$11,160. For cars weighing more than 6,000 pounds but not more than 14,000 pounds that are placed in service on October 23, 2004 or later, the first-year expense limit is reduced to \$25,000. See pages 17–20 for more about writing off the cost of a car.

**Property you already own.** The special first-year write-off is not allowed when you take property you have been using for personal purposes and convert it to a business use. In such cases, your only choice is to depreciate the property, based on the lower of its cost or its value at the time you began using it for business.

#### *Depreciation deduction*

If you can't deduct the full cost of all your purchases under the first-year write-off, you should depreciate the rest.

The method of depreciation used for business property is known as "MACRS" (Modified Accelerated Cost Recovery System). It lets you depreciate most business property over five or seven years, and to some extent you can claim larger depreciation deductions in the first few years after purchase.

Computers, modems, fax machines, typewriters, tape recorders, cameras, calculators and the like are depreciated over five years; office furniture, such as desks, chairs, file cabinets and safes, is depreciated over seven years. (However, you must actually claim the deductions over the first six or

eight calendar years, respectively, since you get a half-year's depreciation in the first and last years.)

If you purchase “off-the-shelf” software, you can write it off over the course of 36 months after purchase. Such software also qualifies for the Section 179 \$500,000 first-year expense limit. Software that has a useful life of less than a year (such as tax preparation software that must be replaced each year) can be written off completely in the year of purchase.

Costs for online services, such as AT&T or Verizon, are not the same as costs for software you purchase. They are treated like a phone bill or utility charge. Unless you pay your bill for future years in advance, you should not have a problem deducting these expenses, provided that you use the services for your business.

**Computers, cellular phones and other “listed property.”** Certain types of business property are called “listed property” and are subject to additional restrictions. Listed property includes cars, cellular phones and equipment that is normally used for entertainment or recreation, such as photographic, audio, communication and video recording equipment. Computers are included on the list unless they are used in a qualifying home office, meaning you *never* use them for personal purposes. (See pages 20–23 regarding the requirements for a home office deduction.) Substantiation requirements have been relaxed for personal use of an employer-provided cellular phone.

Generally, your business use of listed property must exceed 50 percent in order for you to take the special Section 179 first-year write-off, first-year bonus depreciation or depreciate the property under MACRS. (Otherwise, you must use straight-line depreciation.) If your business use drops below 51 percent in any year after the first year you use the property in your business, you may have to pay back some of the “excess” depreciation you claimed.

**Claiming depreciation.** Whether you are an employee or self-employed, you must complete Form 4562 to report your depreciation or Section 179 first-year write-off in any year that you begin to depreciate a new item. If you have listed property, you must file Form 4562 every year you claim any depreciation on the item. Also, if you're an employee claiming depreciation on a vehicle, you must file Form 4562 each year.

If you sell or get rid of property for which you've ever claimed a depreciation deduction, you may have a taxable gain or a loss. If you owned the property for more than a year, any gain would generally be treated as a capital gain, taxable at no more than 20 percent, or 0 percent for those in the 10 or 15-percent tax bracket. The top capital gain rate is 20 percent for taxable income over \$415,050 for single filers, \$466,950 for joint filers in 2016 (\$418,400 and \$470,700 respectively in 2017) and remains at 15 percent for those in the upper tax brackets but below these thresholds. Real property has a special depreciation recapture rate of 25 percent.

**Repair regulations.** The IRS issued final tangible property regulations effective in 2014 addressing the capitalization or expensing of tangible property. For more information, consult your tax advisor or see IRS Publication 946, *How to Depreciate Property*.

### **Office Supplies**

Although as a rule you should depreciate any equipment that has a useful life of more than one year, you don't have to depreciate every stapler or box of paper clips you buy. The IRS finalized in 2013 extensive regulations providing guidance on depreciating and expensing property.

In practice, most accountants recommend setting a minimum threshold amount (e.g., \$200) on the property you will depreciate. Items costing less can be written off as "supplies" in the year that you purchase them.

You also can deduct the cost of consumable office supplies like paper, envelopes, computer diskettes, printer cartridges, film, blank audiotapes and even old-fashioned pencils as you purchase them. Don't abuse this rule by purchasing a five-year supply at one time, unless you are prepared to show the IRS that you got a tremendous volume discount!

### **Home Telephones**

Although you may deduct long-distance and separately charged local business calls, you can't deduct any part of the basic charge for bringing the first phone line into your residence. The cost of optional services such as Call Waiting or Call Forwarding, or the cost of bringing additional phone lines into your home, would be fully deductible as long as you have a business purpose.

**Tax Tip:** If you do substantial amounts of work at home, you may want to consider establishing a second phone line or cellular phone and making all business calls from that phone. This would greatly simplify your tax records — just save the phone bill from the second line. Alternatively, consider using a separate long-distance phone company for your business calls.

### **Professional Journals and Dues**

You may deduct the cost of subscriptions to trade journals in your field, the cost of membership in professional organizations for journalists or writers and the cost of membership in nonprofit civic organizations like the Chamber of Commerce, Lions Club, Kiwanis Club, etc.

### **Union Dues**

If you belong to a union, the initiation fee and the periodic dues are deductible in the year you pay them. You also can deduct assessments for benefit payments to unemployed members.

However, you can't deduct the portion of your dues or contributions (if any) that go to a union pension fund or a fund for the payment of sickness, accident or death benefits.

### **Other Expenses**

Although we've covered the principal categories of expenses applicable to most reporters and photojournalists, you can also deduct any other ordinary and necessary expenses you have in the course of pursuing your career, such as:

- Advertising or other marketing expenses
- Agency fees and commissions
- Answering services
- Business cards
- Casualty losses
- Copyright permissions (paid to use others' copyrighted material)
- Copyright recording and/or legal fees
- Gifts valued at up to \$25 to business associates (including sources)
- Fees for outside editors, proofreaders, indexers, etc., to work on your manuscript
- Legal fees (contractual matters, libel cases, etc.)
- Libel insurance
- Online information services
- Postage or package delivery services, including insurance

You can deduct virtually any reasonable out-of-pocket expense you have while researching a story, article or book, even if your manuscript is eventually rejected. However, you can't deduct the value of your time spent working on a project for which you weren't paid. Deductions are limited to items for which you make some sort of outlay of money or property.

Along similar lines, you may have wondered whether you can take a bad debt deduction if someone skips out on paying you for work you have done. The answer is usually no. Bad debt deductions are available only for items on which you have paid tax. The idea is that it is unfair to pay tax on income that you eventually fail to collect, so the deduction (more or less) negates the tax you previously paid.

Most journalists, however, would never have paid tax on the item in the first place. This is because individuals usually use the cash method of tax accounting. This method says that you don't pay tax until you collect the income. If you don't collect, you don't pay — and you don't get a deduction for failure to collect because there is no tax to recoup. (Larger businesses get the deduction because they use the accrual method of accounting, under which they have taxable income at the time they send out the bill. If it later turns out that the bill is never paid, they get a deduction to undo the damage.)

In tallying up your deductions, don't overlook fees you pay for the business side of your work: the cost of an accountant or tax preparer, the annual fee for your business credit card, any bank fees on your business checking account and the annual safe deposit box fee if you keep any important business documents (e.g., your business liability insurance policy) in the box.

## *Records and Reimbursements*

Whether you're an employee or self-employed, and whether you have a generous expense account arrangement or none at all, you'll have to keep records of your business expenses in order to get any tax benefits from them.

In fact, the only time you wouldn't have to maintain at least some record of an expense is when your employer pays a bill directly; for example, if you're traveling out of town to cover a story, and your employer or client pays for your hotel rather than having you pay the bill.

Other than that, you must keep records according to the rules set out by the IRS, so that, if your tax return is audited, you can prove your deductions.

### **Kinds of Evidence**

There are two kinds of evidence that can satisfy the IRS: (1) receipts and other documentary evidence and (2) diaries or other after-the-fact records.

#### *Documentary evidence*

The best evidence for any expense is a bill, cash receipt, credit card receipt or a canceled check showing the amount of the expenses, the date, and who was paid. You *must* keep a receipt for all lodging expenses and for any other expenditure of \$75 or more.

Even when you have documentary evidence, you will need to write down certain additional information showing the business purpose of the expense, the names of persons you entertained (if relevant), etc.

You can simply jot the necessary information down on the back of your receipt and toss it in an envelope or shoe box, or you can record it in a log or account book, as described below.

#### *Logbooks, expense account records, etc.*

The second-best form of evidence is a written log, diary, expense account form or other record that you keep on a daily, weekly or other reasonably frequent basis. This is the only evidence you'll have because no receipts are given for some types of expenses, such as phone calls from phone booths, tips to airport redcaps, etc.

If you record expenses of less than \$75 in your account book, you don't need to save the relevant receipts, except in the case of lodging expenses or charitable contributions.

**Tax Tip:** Although it's not strictly required by the IRS, keeping a complete and up-to-date log or account book may save you a lot of time in filling out your income tax returns. If you use a paid tax preparer, your bill for the service may be considerably lower if you provide him or her with a logbook rather than simply a shoe box full of receipts.

A good format to use is the one provided in *Wolters Kluwer Tax & Accounting's Business Expense Log*. This booklet is updated annually to reflect the latest tax laws and allows you to keep records of car mileage and expenses, computer time and other business expenses.

**Separating expenses.** Generally, you must keep records for each individual expense you have. For smaller expenses, you can create categories such as phone calls, cab fares, etc., and then combine the costs for all expenses in each category on a daily basis. For example, you can record the cost of all phone calls in a day as a single expense.

Meals and entertainment must be in a separate category because only 50 percent of these expenses are deductible. Tips are not recorded separately but are added to the cost of the meal or service on which you paid the tip.

#### **How Long Must Records Be Kept?**

You must keep all the receipts, canceled checks and records needed to support your deductions for at least three years after the date of the income tax return on which you claimed the deductions.

If you were required to turn in your receipts to your employer, don't worry. The IRS does not require you to keep duplicate receipts for most expenses when they were reimbursed under an accountable plan (see pages 39–41).

However, do keep originals or duplicates of records for expenses that were not reimbursed or that were reimbursed under nonaccountable plans. If you're claiming the home office expense or depreciating any major equipment, you should keep records pertaining to the purchase price, any



significant improvements or casualty losses and any depreciation already claimed. Save these records for as long as you own the property and for at least three years after you dispose of the property.

Finally, although not strictly required, it's a good idea to keep copies of your annual income tax forms forever.

### *Destroyed receipts*

If your receipts are unavailable for reasons beyond your control, such as loss by fire, flood or earthquake, you will be allowed to prove a deduction by reconstructing your expenses.

### **Facts You Must Record**

In general, you need to be able to prove the amount, description and business purposes of each expense. Some categories of expenses require you to record more specific information. See the discussions of car expenses beginning on page 17, meal and entertainment expenses beginning on page 23 and travel expenses beginning on page 25.

### **Shortcuts for Records**

For some expenses, the IRS allows you to avoid some of the burdens of keeping exact records if you choose (or your employer allows you) to claim a standardized deduction amount rather than the amounts you actually spent.

One such type of expense is the cost of operating your car. Often you can use the standard mileage rate method of figuring car expenses (see page 17). Another is the simplified home office deduction (see page 20).

Two other "shortcut" methods pertain to traveling expenses. The "high-low method," described below, is available to most journalists, whether self-employed or not, and can greatly simplify the records you need to keep while traveling.

Another shortcut method, the per diem rate, is available only if you are an employee and your employer chooses to use that method in reimbursing your expenses. Per diems are discussed below.

### *The high-low method*

Instead of keeping records of your actual meal expenses, laundry, cleaning and tips while traveling, you can choose to use a rate known as the "high-low method" based on the location of your travel.

**Amount of the allowance.** Under the latest available rates, for October 1, 2015 through September 30, 2016, the meal and incidental expense (M&IE) allowance is a minimum of \$51 per day for areas in the U.S. However, a large number of metropolitan areas are designated “high-cost areas,” qualifying for a higher rate. To find out the rate for your destination, you can ask your employer, check the Internet at [www.gsa.gov](http://www.gsa.gov) or call the IRS at **1-800-TAX-FORM** and ask for Publication 1542, *Per Diem Rates for Travel Within the Continental United States*. For areas outside the continental U.S., you can call the Department of State at **(202) 663-1121** or go to the Internet at [www.state.gov](http://www.state.gov).

If you travel to more than one location during the day, use the rate for the location in which you stop for sleep or rest.

**Travel for less than a day.** If you’re traveling for less than the full 24 hours in a day (e.g., on the first or last day of the trip), you must prorate the M&IE. The proration may be based on either reasonable business practices consistently applied or three-fourths of the applicable per diem rate if the day involved more than 12 hours of travel.

**Applying the 50-percent rule.** If you are not reimbursed for expenses, or if you are reimbursed under a nonaccountable plan, you can only deduct 50 percent of the M&IE amount. Accountable and nonaccountable plans are discussed on pages 39–41.

#### *Per diem allowances*

If your employer reimburses you with a per diem allowance (that is, a set amount per day of travel), you can avoid having to keep detailed records for the meal, lodging and incidental expenses you have while traveling.

Per diems that include lodging are available only if you are an employee who is reimbursed under an accountable plan (see pages 39–41). Otherwise, you are limited to using the M&IE discussed above.

**Federal per diem rates.** The official federal rates for each location are adjusted for inflation periodically. Your employer can tell you the rate for your particular destination. The rates for the current year are listed in IRS Publication 1542, available by calling **1-800-TAX-FORM**.

If you travel for less than the full 24 hours in a day, you must prorate the per diem as discussed above.

**Allowance less than or equal to federal rate.** If the per diem you receive is less than or equal to the federal rate, none of it is counted as taxable income on your W-2 and you don't have to report anything to the IRS. This is true even if your actual expenses were less than the per diem you received. That's the beauty of the per diem arrangement.

However, if your actual expenses were greater than your per diem reimbursement, you can claim the difference as a deduction by filing Form 2106. If you choose to do this, you must be prepared to prove to the IRS the total amount of your expenses and reimbursements for the year.

**Allowance greater than federal rate.** If you receive a per diem that is higher than the federal rate, your employer has to report the allowance amount up to the federal rate in a special box on your W-2. This amount is not taxable. The part of the per diem that is *higher* than the federal rate is included in your taxable income on the W-2.

If your actual expenses are less than or equal to the federal rate, you don't have to declare your expenses by completing a Form 2106.

However, if your expenses are higher than the federal rate, you can complete Form 2106 if you wish. That way, you can deduct those expenses that are over the federal rate as miscellaneous deductions on your Schedule A.

### **Expense Accounts and Reimbursements**

If you are lucky enough to be reimbursed for some or all of your expenses, either by your employer or by the purchaser of your story, photos, article or book, you may have a little more work to do.

If you're self-employed, the payments you receive are treated as part of your gross income and reported on your Schedule C, whether the amounts are earmarked as expense reimbursements or simply as payment for work. All your allowable expenses are deducted from gross income, with the caveat that only 50 percent of meal and entertainment expenses are deductible. (A self-employed journalist would be able to deduct 100 percent of the allowable meal and entertainment expenses, however, if complete, detailed substantiation of the expenses is provided to the client for reimbursement. The client then has the 50-percent restriction.)

If you're an employee, the way you treat reimbursed expenses depends on the type of plan your employer provides. The key distinction to be made

is whether the employer's plan is accountable or nonaccountable. The employer should be able to tell you which type.

*What's an accountable plan?*

An advance payment or expense reimbursement plan can be considered accountable if all of the following are true:

- There is a business connection to all reimbursed expenses,
- You substantiate your expenses with documentation or a per diem applies, and
- You return any unsubstantiated reimbursement within a reasonable time (e.g., 120 days after payment).

*Reimbursements under accountable plans*

If your employer's plan is accountable and you're reimbursed for the exact amount of your allowable expenses, your reimbursements are not reported as income and you don't have to pay Social Security or Medicare taxes on them.

You don't have to file Form 2106 to claim your expenses as deductions because they already are subtracted from your pay.

What's more, you'll get the full benefit of all the reimbursements, including 100 percent of your allowable meal and entertainment expenses. The employer reimburses you for 100 percent of these expenses, but can only deduct 50 percent for itself.

*Reimbursements under other plans*

If your employer's plan is not considered to be accountable, you'll have to file Form 2106 to claim your deductions. Your employer will include the reimbursements in your taxable income on your W-2 form and will withhold Social Security, Medicare and income taxes.

You'll have to subtract the reimbursements from your expenses on Form 2106 and then deduct the difference as a miscellaneous deduction (subject to the 2-percent floor) on your Schedule A.

*Filing even though your employer reimburses*

Sometimes you might file Form 2106 even if your employer has an accountable plan. This might happen if you did not return excess

reimbursements or if the reimbursement was for less than the full amount. You claim the portions (if any) of your expenses that were not reimbursed on Form 2106. Reimbursements for expenses that you did not properly report to your employer and excess reimbursements are included as income on your W-2.

**Reimbursements for nondeductible expenses.** Sometimes an employer with an accountable plan will reimburse you for an expense that the IRS does not allow as a deduction. For example, it might pay for your meals on evenings when you are working late, but not pay for entertaining any sources or contacts. The portion of the reimbursement that pertains to such meals is treated as if it were paid under a nonaccountable plan.

## *Pensions and Health Insurance*

Setting aside current earnings for our later years is important to us all, but it is absolutely crucial for freelance writers, journalists and photographers.

Unlike a small business owner in retailing, manufacturing or even a service profession like insurance or medicine, you can't count on the eventual sale of your business to provide you with a retirement fund. So, you really need to save now if you hope to be able to retire someday.

In order to make saving easier, the government has provided significant tax breaks for those who use approved types of retirement plans. Even those who are employed by a company that provides a generous pension plan should give some thought to taking advantage of these tax breaks.

### **Advantages of Retirement Plans**

You're probably familiar with the major benefit provided by pension plans that meet with IRS approval and are consequently called "qualified."

Through a qualified plan, you can avoid current income tax on a significant amount of your income.

This is because you are not taxed on contributions to the plan made by your employer. You are taxed only when you receive benefits at some point down the road.

Many people believe that the main advantage to deferring tax on some of their current income through a pension plan is that at the time they eventually collect the benefits, they will be retired and in a lower tax bracket.

Since individual and corporate tax rates may go up again in the future, this benefit may be less important to you. Your tax rate at age 60 or 65 may actually be higher than the one you're in now.

However, the fact that qualified pension plan contributions are allowed to earn tax-free interest and dividends, perhaps over a 20 to 30 year period, means that an investment through a qualified plan is likely to result in a significantly larger sum distributed at retirement, regardless of what your tax rate may be at that time.

## Plans for Employees

In most cases, there is little you can do about the type of pension plan your employer has (if any), or the amount of contributions that will be made on your behalf. Nevertheless, it's a good idea to find out as much as you can about any plans that are used, about whether and when your benefits become nonforfeitable or "vested," and about the level of benefits that is projected to be available if you continue to work for your employer until retirement.

### *401(k) plans*

One type of plan that gives you significant control is the 401(k) plan.

This special type of defined contribution plan is named after the law provision that authorizes it, and is being offered by more and more employers. It may be the only retirement plan your company offers, or it may take the form of a supplement to a traditional pension plan.

Under 401(k) plans, employees can choose to receive a portion of their compensation in cash or have it contributed to a qualified retirement plan. Under many plans, the employer may match some or all of the dollars you contribute, which is almost as good as getting a raise.

Employee contributions to 401(k)s are not subject to current income tax, but they are subject to Social Security and Medicare taxes. The interest and dividends earned by your contributions within the plan are not taxed until they are withdrawn.

However, amounts you withdraw from the plan before you reach age 59½ are generally subject to income tax at that point, plus a penalty equal to 10 percent of the amount you withdraw. If you leave your job before reaching 59½, you can avoid the tax and penalty by rolling over your 401(k) account directly into an IRA, SIMPLE IRA or the new employer's 401(k) plan.

**Pros and cons.** The chief advantage of this kind of plan is flexibility; each individual is able to decide whether or not to participate in it and is given choices as to the size of contributions to be made on his or her behalf. In contrast, conventional pension plans do not allow employees to determine the size of their contributions or to receive cash if they decide not to participate.

Moreover, under a 401(k) plan you'll usually be given choices as to the type of investments you want the employer to make for you. Most employers

offer at least three different investment vehicles such as stock or bond mutual funds and money market funds. Some also offer company stock. It's up to you to decide among the options that are offered or to seek professional investment advice if you need help.

One disadvantage of the 401(k) plan is that the annual amount of deferred compensation each employee may contribute is relatively low. For 2016, the amount is set at \$18,000 (\$24,000 for those age 50 or older), remaining the same in 2017. Your 401(k) plan may permit you to make part or all of your contributions to a Roth 401(k) rather than to a regular 401(k). Contributions to a Roth 401(k), like a Roth IRA discussed below, would not qualify for a tax deduction, but later distributions could be tax free.

A 401(k) might not provide a complete solution to the retirement issue, but it can provide an important piece of it.

### *IRAs*

Virtually anyone who works — whether employed or self-employed — can set up his or her own retirement plan in the form of an IRA. The earnings on the plan and gains from sales of assets within the plan accumulate tax-free until they are distributed to you.

IRAs are sponsored by banks, savings and loans, insurance companies, mutual funds, brokerage houses and other financial institutions. Investment choices — and fees — can range widely.

Recently, the rules pertaining to IRAs were significantly changed, so that more people should be encouraged to take advantage of them.

**How much can you contribute?** For 2016, you can contribute up to the lesser of your earned income or \$5,500–\$6,500 if you are age 50 or older (remaining the same for 2017). You can also contribute a similar amount to an IRA for your spouse, provided that your joint earned income exceeds your combined IRA contributions.

However, the amount of your contributions that are tax deductible depends on a number of factors. If either you or your spouse is an active participant in a qualified employer's retirement plan, including a 401(k) plan at any time during the year, the participating individual's ability to make deductible IRA contributions depends on the amount of your total joint modified adjusted gross income (AGI).



If your AGI is below the relevant threshold, you can deduct the full contribution. The phaseout ranges for 2016 are \$61,000 to \$71,000 for singles or heads of household (\$62,000 to \$72,000 for 2017), \$98,000 to \$118,000 for marrieds filing jointly (\$99,000 to \$119,000 for 2017), or \$0 to \$10,000 for marrieds filing separately.

What if your spouse participates in an employer-sponsored retirement plan, but you don't? The non-participating spouse can make a fully deductible IRA contribution so long as the couple's joint income does not exceed the specified limit. The deduction is phased out for 2016 for those with joint AGIs between \$184,000 and \$194,000 (\$186,000 to \$196,000 for 2017).

Note that these limits apply to "new money" that you're putting into an IRA. They don't apply if you are rolling over amounts from an existing IRA to a new one, or from a former employer's qualified retirement plan to an IRA.

**Withdrawals and distributions.** Amounts withdrawn from an IRA are taxable as ordinary income except to the extent that you made nondeductible IRA contributions. (Because the nondeductible contributions have already been taxed, they will be tax-free when they are withdrawn.) You also may have to pay a 10-percent premature distribution penalty if you withdraw money from your IRA before you reach age 59½. The penalty does not apply for either regular IRAs or for Roth IRAs (discussed below) if you take out up to \$10,000 from any type of IRA to buy your first home, you are unemployed and take penalty-free withdrawals to pay for qualified health insurance premiums, or if you pay certain education expenses for yourself or your dependents.

You can't leave your money to accumulate tax-free in your IRA forever. Between ages 59½ and 70½ you can withdraw as much or as little as you like. Once you reach age 70½, you are required to begin withdrawing at least a certain minimum amount each year. Otherwise, a 50-percent penalty tax will be assessed on the amount that should have been distributed.

**Roth IRAs.** The Roth IRA is backloaded; that is, the contributions are not deductible, but the withdrawals from the account, including all the buildup in value over the years, are tax-free as long as certain conditions are met. The conditions are that the withdrawals must be made five years or more after the account was opened and after you attain age 59½, have died or have become disabled; otherwise a 10-percent penalty may apply

to any withdrawals that exceed the original contributions. In addition, after the five-year period, the distribution for first time homebuyers discussed above qualifies for tax-free as well as penalty-free distribution if made from a Roth IRA. Another advantage of Roth IRAs over regular IRAs is that distributions are treated as coming first from previously taxed contributions to Roth IRAs, rather than being prorated between contributions and earnings as is done for regular IRAs.

For 2016, joint filers with AGI under \$184,000 can make full contributions to Roth IRAs; for those with income between \$184,000 and \$194,000, the contribution amount is phased down, until it is phased out completely at \$194,000 (\$186,000 to \$196,000 for 2017). For singles, the phaseout range is between \$117,000 and \$132,000 (\$118,000 to \$133,000 for 2017).

You may be able to convert a “regular” IRA to a Roth IRA or a regular 401(k) account to a Roth 401(k) account. To convert, you must pay taxes at ordinary rates on the full amount not previously subject to tax you want to pour into the Roth IRA or Roth 401(k).

Whatever type of IRA contribution you make, remember that the IRA contribution limits apply to the total retirement IRA contributions each year, whether they are deductible IRAs or non-deductible IRAs and/or Roth IRAs.

### **Plans for the Self-Employed**

In addition to a regular or Roth IRA, self-employed journalists have three, possibly better, choices: they can set up a SIMPLE plan (Savings Incentive Match Plan for Employees), a SEP-IRA (Simplified Employee Pension-Individual Retirement Account) or they can use a Keogh plan.

#### *SIMPLE plans*

A SIMPLE plan is a type of pension plan available to employers with 100 or fewer employees. That probably describes your business if you are self-employed.

A SIMPLE arrangement allows you two options: you can either fund an IRA or set up a plan that runs like a 401(k) plan. The differences between a SIMPLE plan and a regular 401(k) lie in the relative simplicity of administration and in the somewhat lower contribution limits. A regular 401(k) plan will let you put away up to \$18,000 in 2016 and \$18,000 in 2017 (\$24,000 for those age 50 or older). A SIMPLE plan has limits of \$12,500 in 2016 and \$12,500 in 2017 (\$15,500 for those age 50 or older).

Of course, the simplicity issue is not that important, unless you start having a sizeable number of employees. And besides, you won't be handling the administrative details yourself. You will be paying someone else to do it.

### *SEP-IRA*

A simplified employee pension (SEP) is basically a plan under which you set up a special kind of IRA account. This account is governed by most of the regular IRA rules, and earnings on the account accumulate tax-free.

However, you can set up a SEP-IRA in cases where you couldn't make deductible IRA contributions. For example, let's say you're employed by a newspaper that has a pension plan, and that you and your spouse have a combined AGI over \$130,000. You won't be allowed to make any deductible IRA contributions. But if you moonlight as a stringer for another paper or do any other type of freelance work, you can open a SEP and make tax-deductible contributions based on your earnings from self-employment.

The limit on deductible contributions to SEP-IRA can be much higher than the amounts that can go into a regular IRA. You may funnel up to 20 percent of your net self-employment earnings up to \$265,000, for a maximum contribution of \$53,000 in 2016 (\$270,000 and \$54,000 respectively for 2017).

SEP plan contributions are optional. You decide whether to make one or not for any particular year. You can defer this decision until after the year is over, since you can make a SEP contribution for a year as late as April 15 of the following year.

### *Self-employed plans*

If your self-employment income is substantial, you may wish to establish a self-employed plan. Self-employed plans are similar to corporate plans and are generally more complicated and more expensive to set up than SIMPLE plans or SEP-IRAs, but you may be able to stash more money in a self-employed plan.

Self-employed plans come in three basic flavors. With a "profit-sharing plan," you can contribute 20 percent of your net earnings (25 percent after you deduct for the contribution itself), up to \$265,000 in 2016 (\$270,000 in 2017). Profit-sharing plans allow you to vary your contributions from year to year, or skip a year entirely if you wish.

Or, you can set up a “money-purchase plan.” With this type of plan, you can contribute up to the smaller of 20 percent of your net earnings up to \$265,000, or \$53,000, in 2016 (\$270,000 and \$54,000 respectively for 2017). The catch is that you must contribute the same percentage of your profits each year. Otherwise you’ll have to pay a penalty on the underfunded amount. With contribution limits now the same for both forms, the contribution flexibility of the “profit sharing” plan would give the edge to that form over the money purchase plan.

A third type of self-employed plan is the “defined benefit plan.” With this type, you contribute an amount that is designed to eventually pay you a predetermined benefit every year after you retire. Your contribution for a year can be as high as the amount actuarially determined as needed to fund an annual retirement benefit of the lesser of \$210,000 for 2016 (\$215,000 for 2017) or 100 percent of your average earnings for your highest three consecutive years.

A defined benefit plan can be especially useful to an older person who has very substantial income — for example, maybe you finally write that bestseller you’ve been talking about. However, these plans are complicated, expensive to set up and they generally require active management by a pension professional. A combined 401(k) and defined benefit plan is also permitted.

You can set up a self-employed plan at many of the same institutions that offer IRAs, or you can have an attorney or pension plan expert devise an individual plan to suit your needs.

To take a deduction for a self-employed plan contribution for a year, the plan has to be established by the end of the year. However, the contribution can be made as late as the due date of your tax return — for most people, that is April 15 of the following year.

### **Retirement Credits**

Small employers are eligible for a credit up to \$500 per year for up to three years for plan start-up costs.

A credit of up to \$1,000 per year is also available for contributions to an IRA or qualified retirement plan. The maximum credit rate is 50 percent and the credit is completely phased out for single taxpayers with modified AGI of more than \$30,750 in 2016, and more than \$61,500 for joint filers (\$31,000 and \$62,000 in 2017).

## Health Insurance

If you're covered by an employer's health insurance plan, your employer's payments for the insurance are tax-deductible. Premiums included on your Form W-2 in box 1 may be deducted if you itemize your deductions and total medical expenses exceed 10 percent of your adjusted gross income (7.5 percent for people age 65 and over; 10 percent in 2017).

However, if you are self-employed, 100 percent of your health insurance premiums are deductible whether you itemize or not. If you are employed but your employer doesn't provide health insurance and you maintain your own insurance policy, your insurance costs may be at least partially deductible if you itemize your deductions. The premiums would be combined with your family's out-of-pocket medical costs for the year, and the amount that exceeds 10 percent of your adjusted gross income (7.5 percent for people age 65 and older; 10 percent in 2017) would be deductible on Schedule A of Form 1040.

### *Finding health insurance*

Obtaining health insurance at a reasonable price can be a problem for freelancers. If you have recently left employment that provided such insurance, you're entitled to continue coverage under your former employer's plan for up to 18 months, provided that you pay the company-rate premium, plus up to 2 percent as a processing fee. However, you must sign up for this continued coverage (under COBRA) within a very short period of leaving your employment.

If you're not eligible for COBRA insurance, some professional organizations for writers (or other associations to which you belong or join for this purpose) might offer lower group rates than you could obtain on your own. Another possibility is to join an HMO — many have "open enrollment" periods in which they will accept applications from individuals.

Also, your IRA can be used to pay for this coverage. You would be subject to income tax on IRA money withdrawn before age 59½ to pay for COBRA coverage but would not be subject to the 10-percent early withdrawal penalty. Most people who lack a lifetime guarantee to their current jobs ought to consider an IRA just to pay for COBRA coverage in case their job is terminated.

Health reform legislation passed in 2010 has made it possible to find health insurance coverage through state exchanges and without preexisting condition restrictions. These reforms also include a premium assistance tax credit for persons below 400 percent of the federal poverty

level purchasing health insurance through a state exchange to help some individuals pay for health coverage.

Individuals who purchased health insurance through an exchange should receive a Form 1095-A from the exchange showing the insurance premium and any advance premium tax credit received. Individuals can then use Form 8962 to calculate the premium tax credit they should have received and whether they have to repay some of the advance credit with their tax return or whether they are entitled to an additional credit on the return.

Starting in 2015, individuals with employer provided or private health insurance should receive a Form 1095-C and/or 1095-B showing health insurance coverage provided. Individuals who do not obtain coverage may be liable for a shared responsibility tax penalty, unless an exemption applies, of the greater \$625 or 2.5 percent of household income.

#### *Health Savings Accounts*

Individuals and employees with high deductible health plans can, in 2016, contribute up to \$3,350 for self-only coverage and \$6,750 for family coverage into a Health Savings Account (HSA) (\$3,400 and \$6,750 for 2017). An HSA offers a tax deduction for the contribution to the account, tax-deferred earnings in the account, tax-free rollovers, and tax-free distributions from the account for qualified medical expenses. It does not get much better than this.

A high deductible health plan is a plan that, for 2016, has at least a \$1,300 annual deductible for self-only coverage and a \$2,600 deductible for family coverage (\$1,300 for self-only coverage and \$2,600 for family coverage in 2017). The plan must also limit out-of-pocket expenses paid under the plan to \$6,550 for individuals and \$13,100 for families for 2016 (\$6,550 and \$13,100 for 2017).

A catch-up provision permits an additional \$1,000 in contributions for individuals who reach age 55 by the end of the tax year.

Qualified medical expenses include typical medical expenses that qualify for the itemized deduction, including health insurance premiums for medical, dental and long-term care. Starting in 2011, nonprescription drugs will generally not qualify.

Talk to your employer or your health insurance agent about the current availability of HSAs.

*Qualified Small Employer Health Reimbursement Arrangements*

Legislation enacted at the end of 2016 permits employers with less than 50 employees to offer Qualified Small Employer Health Reimbursement Arrangements, under which the employer can reimburse an employee for individual health coverage obtained by the employee. Reimbursement may be up to \$4,950 for single coverage or \$10,000 for family coverage.

## *Tax Planning for Your Future*

Despite all the rules and extreme examples that have been publicized lately, it is not true that you are at the total mercy of the IRS. Pensions and health plans, discussed above, are available in some form to most people, and that is the place to start. But if you are self-employed or have other investments, you may be able to make the tax laws work in your favor.

### **A Delayed Tax Is Money Saved**

“Thou shalt postpone tax as long as possible,” is the central precept of tax planning.

Now, this doesn't mean you should be late with your taxes. The IRS has ways of dealing with people who do that. It means that you should take advantage of the facts that (1) taxes are collected in annual chunks and (2) you often have discretion to determine the year of taxation by properly ordering your affairs.

### *Opportunities if you invest*

Retirement plans, including IRAs, are prime examples of how postponing tax works to your advantage. These plans allow you to postpone the tax on your earnings until you withdraw them at retirement. In the meantime, the funds are invested and you earn money on the interest and dividends. You keep the earnings, not the IRS. Even though you pay tax at the time of withdrawal, you are many dollars ahead because of the extra dollars held in your retirement fund for all those years.

You can do much the same thing with other types of investments. If you buy a stock, you decide when you pay tax on any capital gain because no tax on the gain is due until you sell. If the market cooperates, hold on to the stock until you are in a lower tax bracket (common after retirement) and you've saved a lot of tax.

Even if you don't plan on holding on to a stock, bond, mutual fund or other investment until you're retired, you can take advantage of the special, lower tax rates on capital gains. If you hold the investment for a minimum of 12 months and a day, the maximum tax rate on any gains will be 20-percent for taxable incomes in excess of \$415,050 for single filers and \$466,950 for joint filers in 2016 (\$418,400 for single filers and \$470,700 for joint filers in 2017), 0 percent for those in the 10- or 15-percent tax bracket and 15 percent for those in between.



*Your home can be your best investment*

The same thing is true of other types of property held for investment. The most important example of this is your home. If you play your cards right, you can watch the value of your home increase, move to a new home, watch its value increase, and never pay taxes on any of the increase.

This is made possible by a group of rules that can negate the tax on any profit you may make when you sell your house. One rule gives you a pass on taxes for up to \$250,000 in capital gains when you sell your home (up to \$500,000 for a couple filing jointly). This tax break can generally be used every two years. And finally, another rule says that any accumulated appreciation in your home is erased when you die. So, your heirs can sell immediately without income tax liability. For 2010 only, with the repeal of the estate tax, came limits on the availability of erasing accumulated appreciation when you die.

Turning from eventualities to the present moment, your home also offers other tax advantages. Your biggest ongoing expenses — mortgage interest and real estate taxes — are deductible. Premiums for mortgage insurance may also be deductible, at least through 2016. This can save you a lot of money. Nothing comparable at the federal level is available if you are a renter. These deductions are more than deferrals of tax — they cancel it altogether. As far as they go, they shelter your income from tax you would otherwise owe. If things do not go as planned, however, and the value of your home declines, you cannot deduct a loss on the sale of your home. However, mortgage debt forgiven, if you sell at a loss, may escape tax, under a provision in effect through 2016.

*Business strategies*

If you're self-employed, you can carry the deferral concept one step further. As a freelancer, you may have the flexibility of deciding when to collect your income and when to incur expenses.

If you are due to be paid for a job in December, arrange to be paid in January. A few days' delay can mean a year's delay in tax. On the other hand, if you need a new computer, take advantage of post-holiday sales and lock in the deduction before the end of the year. A deduction today is worth more to you than a deduction next year.

Use your ingenuity (legally, of course) or consult with a tax professional to come up with other ideas for improving the tax timing of your transactions.

### *Alternative Minimum Tax*

In evaluating tax savings strategies, the alternative minimum tax (AMT) should always be considered. As its name implies, it is an alternative tax system with its own income and deduction rules originally designed to force wealthy taxpayers to pay at least some income tax. Over the years, however, it is catching more and more middle income taxpayers. Consult with a tax advisor since some tax planning strategies may not work if you are subject to the AMT.

### **Taxes and Your Heirs**

We've talked a lot about income tax and Social Security tax and how they impinge on your ability to accumulate wealth, however much or little. But what happens to the accumulation after you have shuffled off this mortal coil?

If the pile of money you leave behind adds up to less than \$5.45 million in 2016 or \$5.49 million in 2017, your heirs will have no worries from the IRS. The estate tax doesn't kick in until then. The estate tax disappeared in 2010, but year-end legislation gave estates the option for 2010 to pay an estate tax with a \$5 million exemption and have any income tax on pre-death gains eliminated. In 2016 and beyond, you can also give away tax free up to \$14,000 each year to as many recipients as you desire; if you're married and your spouse consents to the gift, you can give each recipient up to \$28,000. Gifts over these amounts will reduce your 2017 \$5.49 million lifetime gift tax exclusion, however. (The gift tax exclusion is unified with the estate tax exclusion, which means using up part of one also uses up part of the other.)

Before you dismiss the estate tax (or maybe you are lucky enough to be concerned about it), consider two things: (1) home prices have gone up so much that many middle-class homeowners may have considerable assets in real estate, and (2) if you collect royalties on your work, you have a property that has a value that will be taken into account for estate tax purposes. If you think your copyrights have any significant value, consult a professional to determine if they will cause your estate to pay any estate tax.

But why should you care if the inevitable is inevitable? Well, death is inevitable, but the estate tax is not. A professional can help you set up arrangements including trusts, gift plans and charitable arrangements that can reduce or eliminate any estate tax that would otherwise be due. Estate tax planning can also be helpful to make sure your assets pass to the beneficiaries you desire even aside from tax issues.

## *Returns and Audits*

Each year you are called upon to report all your income and deductions to the IRS and settle up any tax due. That is the time you get out your records and fill out the dreaded 1040 or get someone to do it for you.

There's no way to avoid it unless you stop having income! But there is help.

### **Getting Professional Tax Help**

If you are self-employed, chances are you may profit from seeking help in preparing your return. The problem is: there are a lot of tax preparers out there. How can you find someone good for you?

The best place to start is to ask people you know whose financial and/or professional situation is similar to your own. People who are satisfied with their accountants or preparers will be happy to pass along a recommendation. If that approach doesn't pan out, check out your local CPA association referral service.

Before you sign up with anyone, however, make sure that you find out the focus of your tax professional's practice. Does his or her specialty match your needs? Do you have any out-of-state transactions? Make sure the professional is prepared to handle them. Make sure the professional has a Preparer Tax Identification Number (PTIN) and includes that number and the preparer's name at the bottom of the tax return.

Make sure you understand how you will be billed. Will he or she have time for your questions or to help you with planning, as well as with filing your return? Find out if the professional is aggressive or conservative. You will be on the hook for anything that goes on the return, so make sure that you are comfortable with the preparer's general approach.

Finally, ask about the tax professional's audit experience. Will he or she represent you if you are audited, and does he or she have the experience to do a good job? (Too much audit experience may be a sign of an aggressive return preparer.)

What about the confidentiality of your tax information? You may have heard that under 1998 tax legislation, the lawyer-client privilege of confidentiality has been extended to tax advice from Certified Public Accountants, enrolled agents and enrolled actuaries. In theory, the privilege allows you to confide in a professional without fear that your advisor can be compelled to reveal

the information in court or to the government. However, the privilege does *not* include information you provide to any professional, even a lawyer, merely to enable the professional to prepare a tax return.

Whether you get help or prepare your own return, tax time will be much easier on you if your records are in order. If they're not, and you're getting help for the first time, get help on setting yourself up for the future as well.

### **Eligibility for Tax Relief**

Accredited correspondents serving in a combat zone or a qualified hazardous area in support of the U.S. Armed Forces may qualify for additional time to file tax returns, pay taxes or to take other actions with respect to taxes.

### **How to Handle an Audit**

There are two pieces of advice you should keep in mind about audits. First, if you've done your homework and kept good records, and if your return is truthful, you don't have anything to worry about. Second, it's better not to be audited.

#### *Minimize the risk of audit*

Let's talk about the second point.

The average taxpayer has a very small chance of being audited, and you may have an average return. But if you are self-employed, your return is not typical of the millions of returns filed by employees. You may be waving some red flags at the IRS and increasing your chances of being audited. The IRS does not give details on its audit criteria, but professionals offer the following suggestions for minimizing your risk:

- Make sure that the information provided on any W-2s you receive from employers and 1099s or 1098s you receive from banks, mutual funds, brokerages or any other source is accurately reflected on your return. If there is a mistake, get the issuer of the form to correct it. The IRS computer matches these figures with the figures on your return, and it will question any mismatch. If you have many of these forms, report each one separately somewhere on your return. The computer will not catch it if you lump the numbers together.
- If you are claiming an unusual deduction or there is something confusing on your return, attach a written explanation.

If you are claiming home office expenses or significant travel or entertainment expenses, make sure you have the records. The IRS scrutinizes these expenses very carefully. The same is true of all business expenses if you haven't yet established a track record.

- Sign your return. Fill out all the information required. For example, it's common to omit the Social Security number of an ex-spouse from a return, but you are required to supply it if you are paying alimony. Make sure your return is complete.
- Make sure your math is correct. Your tax professional should do this. If you're doing your own taxes, tax preparation software will help. But it is your responsibility. Double check your figures.

#### *What to expect if you are audited*

The IRS has various levels of audits. If questions arise about your math, items seem to be omitted from your return or your figures don't match those on your W-2s, 1099s or 1098s, the IRS may simply request a correction or explanation by mail. Respond to the request as quickly as possible and be sure to consult your tax professional if you have one. The IRS makes mistakes also, so don't assume the IRS is right. Check things out.

The first level of a true audit occurs when you get a letter requesting that you come into the IRS office to review one or more areas on your return. This is a true audit because the IRS is asking for proof of items on your return that goes beyond your own word. If you have kept records, including bills, receipts and canceled checks, you shouldn't worry. The IRS may end up interpreting your situation differently than you, but there is no crime in having differences of opinion. Nevertheless, professional help may be in order.

As rare as audits are, the dreaded visit from the IRS agent is even rarer. Individuals almost never are audited in this way. On-site or "field audits" are used mainly for businesses, particularly when records are not portable. Don't expect this to happen to you.

If your tax return is selected for an office audit, you can have your attorney, CPA, enrolled agent or the paid preparer who signed your tax return accompany you during the audit, or you can give him or her the power to represent you without your actual presence. You can elect on your tax return to have the IRS contact your tax professional directly if they have a question about the return.

If you're in the middle of an audit and find that you are missing some records or need to consult an expert, you can stop the audit midstream and reschedule it for a later date. And, if you run into difficulties with the agent conducting the audit, you can ask to speak to his or her supervisor.

If you disagree with the ultimate results of the audit, there are numerous avenues of appeal that you can pursue. However, at that point, we recommend that you talk to a tax professional to gauge the likelihood of success and the best strategy to use in your particular case. For more information, see the IRS's free Publication 556, *Examination of Returns, Appeal Rights and Claims for Refund*, available by calling **1-800-TAX-FORM**.

The IRS has also resumed a practice of performing random audits to test the validity of its criteria for selecting returns for audit. There are various levels of random audits. If selected, talking to a tax professional is again a good idea to make sure that you understand your rights.

## *Glossary of Tax Terms*

**ABLE accounts.** Tax-favored accounts that permit, starting in 2015, accumulation of funds for qualified expenses of persons with disabilities through state-sponsored programs.

**Accelerated depreciation.** A depreciation method that allows larger deductions in the early years of an asset's "life" and smaller deductions at the end of the period. (See "Straight-line depreciation.")

**Accrual method (or accrual basis).** One of two main accounting methods for determining when a transaction has tax significance. The accrual method says that a transaction is taxed when an obligation to pay or a right to receive payment is created (for example, at the time products are delivered, services rendered, billings sent, etc.). This method is used by all but the smallest businesses. (See "Cash method (or cash basis).")

**Accumulated earnings tax.** An additional tax on corporations that retain earnings to avoid the normal tax on dividends received by shareholders. For most corporations, a reasonable amount may be retained for business purposes without tax.

**Additional Medicare contribution tax.** A 0.9-percent tax on earned income in excess of \$200,000 for single filers, \$250,000 for joint filers.

**Adjusted basis.** The cost of property (or a substitute figure — see "Basis") with adjustments made to account for depreciation (in the case of business property), improvements (in the case of real estate), withdrawals or reinvestment (in the case of securities, funds, accounts, insurance or annuities), etc. Adjusted basis is part of the computation for determining gain or loss on a sale or exchange and for depreciation.

**Adjusted gross income (AGI).** The amount of income considered actually "available" to be taxed. Adjusted gross income is gross income reduced principally by business expenses incurred to earn the income and other specified reductions (such as alimony).

**Alternative minimum tax (AMT).** An alternative tax system that says: your tax shall not go below this level. The alternative minimum tax works by negating (or minimizing) the effects of tax preferences or loopholes.

**Amortization.** The write-off of an amount spent for certain capital assets, similar to depreciation. This tax meaning is different from the common meaning of the term that describes, for example, payment schedules of loans.

**Anti-conversion rules.** Rules to prevent certain investors from converting ordinary income into capital gains. The rules come into play when an investment is the functional equivalent of a loan.

**Applicable Federal Rates (AFRs).** Minimum interest rates that must be charged on various transactions that involve payments over a number of years. If the parties to a transaction do not adhere to these rates, the IRS will impute the interest. (See “Imputed interest.”)

**At-risk rules.** Rules that limit an investor’s deductible losses from an investment to the amount invested. Complications arise when investors finance their investment through loans that they are not personally on the hook for (nonrecourse financing). Without these rules, investors could raise their deduction limit considerably without being at-risk for the actual loss.

**Basis.** The starting point for computing gain or loss on a sale or exchange of property or for depreciation. (See “Adjusted basis.”) For property that is purchased, basis is its cost. The basis of inherited property is its value at the date of death (or alternative valuation date). The basis of property received as a gift or a nontaxable transaction is based on the adjusted basis of the transferor (with some adjustments). Special rules govern property transferred between corporations and their shareholders, partners and their partnership, etc.

**Bonus Depreciation.** Special depreciation, usually in the first year, added to the tax law temporarily to stimulate the economy.

**Cafeteria plan.** A plan maintained by an employer that allows employees to select from a menu of taxable and nontaxable benefits.

**Capital expenditures.** Amounts spent to acquire or improve assets with useful lives of more than one year. These expenditures may not be deducted, but are added to the basis of the property (See “Adjusted basis.”) and, for business property, may be converted into deductions through depreciation or amortization.



**Capital gain or loss.** Gain or loss from the sale or exchange of investment property, personal property (such as a home) or other “capital asset,” which is often entitled to preferential tax treatment.

**Carrybacks and carryforwards.** Deductions that may be transferred to a year other than the current year because they exceeded certain limits. These deductions are typically carried back to earlier years first and, if they exceed the limits for those years, are then carried forward to later years until the deduction is used up. Charitable contributions and net operating losses are examples of deductions that may be carried back or forward.

**Cash method (or cash basis).** One of two main accounting methods for determining when a transaction has tax significance. The cash method says that a transaction is taxed when payment is made. This method is used by most individuals. (See “Accrual method (or accrual basis).”)

**Community property.** A system governing spousal ownership of property and income that is the law in certain western and southern states and Wisconsin. The differences between community property and “common law” can change how federal tax law applies to spouses. For example, married taxpayers filing separately in a common law state do not have to report income earned by the other spouse. They do have to report income earned in a community property state.

**Consolidated return.** A single umbrella return filed by affiliated corporations (eliminating all intercompany transactions) instead of each filing a separate return.

**Coverdell Education Savings Accounts (ESAs or Coverdell ESAs).** IRA-like accounts that provide tax-free distributions for elementary and secondary, as well as college, educational expenses.

**Credit.** A tax credit reduces dollar for dollar a tax otherwise owed.

**Deduction.** A tax deduction reduces taxable income. “Above-the-line” deductions are deducted in calculating AGI. Itemized deductions, or, in the alternative, the standard deduction, are deducted in calculating taxable income.

**Deferred compensation.** An arrangement that allows an employee to receive part of a year’s pay in a later year and not be taxed in the year the money was earned.

**Depletion.** A system similar to depreciation that allows the owner of natural resources (such as a coal mine or an oil well) to deduct a portion of the cost of the asset during each year of its presumed productive life.

**Depreciation.** A system that allows a business or individual to deduct a portion of the cost of an asset (“recover its cost”) during each year of its predetermined “life” (or “recovery period”).

**Earned income.** Income earned by working for it. Interest, dividends and other kinds of profits are examples of unearned income.

**Earned income credit.** A tax credit available to individuals with low earned income. An individual is entitled to the full amount of this credit even if it exceeds the amount of tax otherwise due (i.e., the credit is “refundable”).

**Earnings and profits.** The pot from which a corporation pays dividends. Earnings and profits include both current and accumulated taxable income and nontaxable income. Corporate distributions that are made from another source are not dividends from a tax standpoint.

**Education Savings Accounts (ESAs).** See “Coverdell Education Savings Accounts.”

**Employee stock ownership plan (ESOP).** A type of profit-sharing plan in which benefits come in the form of stock in the employer.

**Estimated tax.** Quarterly downpayments on a year’s taxes that are required (on April 15, June 15, September 15 and January 15) if the total year’s taxes will exceed \$1,000 and the amount is not covered by withholding.

**401(k) plans.** A type of qualified retirement plan that permits an employee to elect the amount to contribute to the plan, up to certain limits.

**Federal Insurance Contributions Act (FICA).** Social security taxes (for both old-age, survivors and disability insurance — OASDI — and Medicare).

**Federal Unemployment Tax Act (FUTA).** Unemployment taxes.

**Filing status.** One of four tax ranks determined by your marital status, your dependents and the way you file your tax return: (1) single, (2) married filing jointly, (3) married filing separately and (4) head of household. Filing status

determines your tax rates and your eligibility for various tax benefits (such as an alimony deduction, an IRA deduction or a standard deduction, etc.).

**First-in, first-out (FIFO).** A rule that applies to the sale of part of a group of similar items (such as inventory, shares of the same stock, etc.) that assumes the first ones acquired were the first ones sold. This is important if the items in the group were acquired or manufactured at different times or for different costs. The rule may be overridden by identifying the specific item sold, if possible. (See “Last-in, first-out (LIFO).”)

**Flexible Spending Account (FSA).** An account set up by an employee with an employer to use pre-tax dollars to fund medical or dependent care expenses. Funds deposited in the FSA must generally be used for the specified purpose during the year or they are lost.

**Foreign Account Tax Compliance Act (FATCA).** Legislation enacted in 2010 requiring reporting to the IRS of information with respect to foreign-held assets of U.S. citizens and residents.

**Foreign Bank and Financial Accounts Report (FBAR).** An FBAR is a banking report on foreign account holdings that is administered by the IRS and now due at the same time as individual tax returns.

**Generation-skipping transfer (GST) tax.** An extra tax on gifts or on-death transfers of money or property that would otherwise escape the once-per-generation transfer taxes that apply to gifts and estates. A gift from a grandfather to a granddaughter skips a generation and might be subject to this tax, for example.

**Golden parachutes.** Bonuses payable to key executives in the event control of their corporation changes, as in the case of a takeover. “Excess” golden parachute payments are subject to tax penalties.

**Grantor trust rules.** Rules that prevent someone from transferring property to a trust (to take advantage of decreased taxes) without really giving up ownership of the property. If the rules are violated, the “grantor” is treated as continuing to own the property.

**Gross income.** All income that might be subject to tax. Most “realized” increases in wealth are considered income. The main exceptions for individuals are gifts, inheritances, increases in value of property prior to

sale, loan repayments and some personal injury awards. For businesses, investments in their capital are not considered income.

**Head of household.** A filing status available to qualifying single parents (or others supporting certain dependents) that allows lower taxes than the normal rates for singles.

**Health Reimbursement Accounts or Arrangements (HRAs).** Employer-funded accounts to reimburse employees for out-of-pocket medical expenses not covered by the employer's health insurance plan. (See "Qualified Small Employer Health Reimbursement Arrangements.")

**Health Savings Account (HSA).** An investment fund similar to an IRA that can be used to pay for medical expenses and Medicare insurance premiums, when used in conjunction with "high deductible" health insurance. HSAs are broadly available to individuals and employees and offer both a tax deduction for contributions and tax-free distributions. (See "Medical Savings Accounts.")

**Imputed interest.** A portion of a future payment that is treated as interest if parties to the transaction do not provide a stated amount of interest at a rate acceptable to the IRS. (See "Applicable Federal Rates (AFRs).") This prevents improper use of certain tax advantages (capital gains rates or tax deferral). For example, if a business sells an asset on the installment basis, part of all future payments is treated as interest whether the transaction states it or not.

**Incentive stock option (ISO).** A stock option that may be granted to an employee under tax-favored terms.

**Itemized deductions.** Personal deductions that may be taken if they total more than the standard deduction. (See "Standard deduction.") The following deductions are then itemized or listed on Schedule A of Form 1040: medical expenses, charitable contributions, state and local taxes, home mortgage interest, real estate taxes, casualty losses, unreimbursed employee expenses, investment expenses and others.

**Investment credit.** A credit against tax available for investment in a limited range of business property. The general investment credit was repealed in 1986, but this type of credit has been enacted and repealed repeatedly throughout history.

**Involuntary conversion.** The conversion of property into money under circumstances beyond the control of the owner. For example: (1) property that is destroyed and “converted” into an insurance settlement or (2) property that is seized by the government and “converted” into a condemnation award. Owners may avoid tax on any gain that may result (if the insurance settlement or condemnation award exceeds the adjusted basis of the property) by reinvesting in similar property within certain time limits.

**Joint return.** An optional filing status available to married taxpayers that offers generally (but not always) lower taxes than “married filing separately.”

**Last-in, first-out (LIFO).** A rule that applies to the sale of part of a group of similar items in an inventory that assumes the last ones acquired were the first ones sold. This is important if the items in the group were acquired or manufactured at different times or for different costs. (See “First-in, first-out (FIFO).”)

**Like-kind exchanges.** Tax-free Swaps of investment property. Commonly used for real estate. (See “Swaps.”)

**Limited liability company (LLC).** A legal structure that allows a business to be taxed like a partnership but function generally like a corporation. An LLC offers, among other things, members protection against liability for claims against the business.

**Listed property.** Property listed in the tax code or by the IRS that must comply with special rules before depreciation may be claimed. Cars and personal computers are examples of listed property. The special rules are designed to prevent deductions where the property is used for personal rather than business purposes.

**Medical Savings Accounts (MSAs or Archer MSAs).** An investment fund similar to an IRA that can be used to pay more routine medical expenses, when used in conjunction with “high-deductible” health insurance, which pays the big bills. Only 750,000 of these MSAs are available nationwide under a pilot program. No new MSAs have been authorized since 2007. To qualify, you have to be self-employed or employed by a small employer that offers the program. (See “Health Savings Accounts.”)

**Modified Accelerated Cost Recovery System (MACRS).** The system for computing depreciation for most business assets.

**Modified Adjusted Gross Income (MAGI).** Adjusted gross income modified in certain respects for purposes of determining a particular threshold or phaseout. One of the common modifications relates to foreign taxes.

**MyRAs,** Retirement accounts permitting small after-tax payroll deductions to invest in government savings bonds and transferability from job to job and tax-free withdrawals in retirement or rollovers into Roth IRAs.

**Net investment income tax.** A Medicare tax to pay for health care reform equal to 3.8 percent of the lesser of net investment income or adjusted gross income in excess of \$200,000 for single filers or \$250,000 for joint filers.

**Net operating loss.** The excess of business expenses over income. A business may apply a net operating loss to get a refund of past taxes (or a reduction of future taxes) by carrying it back to profitable years as an additional deduction (or by carrying it forward as a deduction to future years).

**Original issue discount (OID).** The purchase discount offered on some bonds (and similar obligations) in lieu of interest, such as zero-coupon bonds. OID is generally treated as interest income to the holder rather than as a capital gain.

**Passive activity loss (PAL).** Loss on an investment that is deductible only up to the limit of gains from similar investments. The limit mainly affects tax shelters and does not apply to stocks, bonds or investments in businesses in which the investor materially participates. Special rules apply to investments in real estate.

**Premium Assistance Tax Credit.** A refundable credit to assist in the purchase of health insurance through a state exchange.

**Qualified plan.** A retirement or profit-sharing plan that meets requirements about who must be covered, the amount of benefits that are paid, information that must be given to plan participants, etc. Qualified plans are entitled to tax benefits unavailable to nonqualified plans.

**Qualified Small Employer Health Reimbursement Arrangement (QSEHRA).**

Health reimbursement arrangement which meets certain coverage and dollar limits to avoid penalties under the Affordable Care Act. (See “Health Reimbursement Accounts or Arrangements.”)

**Real estate investment trust (REIT).** A kind of “mutual fund” that invests in real estate rather than stocks and bonds.

**Real estate mortgage investment conduit (REMIC).** A kind of “mutual fund” that invests in real estate mortgages rather than stocks and bonds.

**Recapture.** The undoing of a tax benefit if certain requirements are not met in future years. For example: (1) the low-income housing credit may be recaptured or added back to tax if the credit property ceases to be used as low-income housing for a minimum number of years. (2) The alimony deduction may be retroactively lost or recaptured if payments do not continue at the requisite level for a minimum number of years.

**Refundable credit.** A tax credit to which a taxpayer may be entitled even if no tax is otherwise owed, resulting in a refund to the taxpayer. A nonrefundable credit can only offset a tax otherwise due.

**Regulated investment company (RIC).** A mutual fund.

**Rollover.** The tax-free termination of one investment and reinvestment of the proceeds. For example: an individual may roll over a lump-sum distribution from an employer’s retirement plan into an IRA.

**Roth 401(k).** The portion of a 401(k) plan that permits all or part of the employee contribution to go into an account similar to a Roth IRA account.

**Roth IRA.** IRAs with nondeductible contributions but with potentially tax-free withdrawals.

**S corporation.** A corporation with no more than 100 shareholders that is not taxed, but treated similarly to a partnership, if other requirements are met.

**Savings Incentive Match Plan for Employees (SIMPLE plans).** A simplified retirement arrangement for small businesses that comes in two varieties: one similar to a 401(k) plan and one that funds IRAs for employees.

**Shared responsibility payment (individual mandate).** A tax penalty imposed on certain individuals who fail to purchase health insurance.

**Simplified Employee Pension (SEP)-IRA.** An IRA for self-employed persons and small businesses with higher contribution limits than regular IRAs.

**Standard deduction.** A deduction allowed individuals instead of listing or itemizing deductible personal expenses. (See “Itemized deductions.”) The amount depends on the individual’s filing status. Additional amounts are available for taxpayers who are blind or are age 65 or over. Individuals may deduct either their standard deduction or the total of their itemized deductions, whichever is greater.

**Straight-line depreciation.** A depreciation method that allows equal deductions in each year of an asset’s “life” or recovery period. (See “Accelerated depreciation.”)

**Swaps, tax-free.** (1) Exchanges of like-kind property that result in no capital gains tax (commonly used for real estate). (2) Sales and repurchases of stock (or other securities) designed to realize a tax loss without discontinuing the investment. Transactions must comply with the wash sale rules to be effective. (See “Wash sales.”)

**Taxable income.** What is left after all deductions are taken. This is the amount upon which tax is computed.

**Taxpayer identification number (TIN).** In the case of an individual, the Social Security number. In the case of a business (even an individual in business), the federal employer identification number (FEIN).

**Top-heavy plan.** An employee retirement or profit-sharing plan that disproportionately benefits top executives.

**Uniform capitalization rules (Unicap).** A set of uniform rules for computing the cost of goods produced by a business that prevents current deductions for costs that must be capitalized (See “Capital expenditures.”) or added to inventory.

**Wash sales.** Simultaneous or near-simultaneous purchases and sales of the same property, usually stocks or bonds, made to generate deductible tax losses without discontinuing the investment. Losses on the transactions



are ignored for tax purposes, however, unless a 30-day waiting period is observed between them.

**Withholding allowances.** Adjustments made to assure correct withholding on wages for individuals who may have unusually large deductions or who may be subject to other special circumstances.

## 2017 Tax Rates

The following chart shows the threshold dollar levels at which each of the seven tax brackets begins for 2017, depending on filing status. Note that to arrive at the amount to plug into the chart, you'll first have to figure adjusted gross income, and then subtract your itemized or standard deduction and your personal exemptions (the 2017 exemption is \$4,050 per eligible family member).

The 2017 standard deductions are \$6,350 for singles, \$12,700 for marrieds filing jointly, \$6,350 for marrieds filing separately and \$9,350 for heads of household.

### Dollar amount where each bracket begins for each filing status

Tax Bracket	Single	Married filing jointly	Married filing separately	Head of household
10%	0	0	0	0
15%	\$9,325	\$18,650	\$9,325	\$13,350
25%	\$37,950	\$75,900	\$37,950	\$50,800
28%	\$91,900	\$153,100	\$76,550	\$131,200
33%	\$191,650	\$233,350	\$116,675	\$212,500
35%	\$416,700	\$416,700	\$208,350	\$416,700
39.6%	\$418,400	\$470,700	\$235,350	\$444,550

## 2014 Average Itemized Deductions\*

The following are the latest figures released by the IRS (their reports lag behind the current tax year because of the time needed to compile figures). These are averages only. The IRS takes a dim view of taxpayers who base their claimed deductions on these figures.

The numbers are useful, however, for two purposes: (1) to see if your actual deduction is out of line (so you can take extra care to document your claim) and (2) to see if the deductions meet the expectations of policymakers.

Also, note that these averages take into account only those individuals who claimed an itemized deduction for that type of expense. Zero deductions are not factored in. Thus, the “average” taxpayer with adjusted gross income between \$30,000 and \$50,000 did not take an “average” medical expense deduction of \$8,209, only the “average” taxpayer who itemized medical expenses did.

Adjusted Gross Income	Medical Expenses	Taxes	Interest	Contributions
\$15,000 to \$30,000	\$8,477	\$3,376	\$6,619	\$2,339
\$30,000 to \$50,000	\$8,209	\$4,098	\$6,511	\$2,594
\$50,000 to \$100,000	\$9,614	\$6,679	\$7,553	\$3,147
\$100,000 to \$200,000	\$11,122	\$10,983	\$9,147	\$4,130
\$200,000 to \$250,000	\$18,092	\$17,763	\$11,642	\$5,786
\$250,000 or more	\$38,992	\$50,679	\$16,982	\$21,596

\* Based on Preliminary 2014 IRS Statistics

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