PROFESSIONAL EDITION

J.K. LASSER'S™ YOUR INCOME TAX

2017

J.K. LASSER'S™

YOUR INCOME TAX 2017

PROFESSIONAL EDITION

Prepared by the
J.K. LASSER INSTITUTE™

WILEY

Staff for This Book

J.K. Lasser Editorial

Elliott Eiss, Member of the New York Bar, Contributing Editor
Barbara Weltman, Member of the New York Bar, Contributing Editor
Angelo C. Jack, Production Manager
William Hamill, Copyediting and Proofreading
Index by WordCo Indexing Services

John Wiley & Sons, Inc.

John Wiley & Sons, Inc.
111 River Street
Hoboken, NJ 07030

Published by John Wiley & Sons, Inc., Hoboken, New Jersey
Published simultaneously in Canada

ISBN 978-1-119-24823-1

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

Eightieth Edition

How To Use the Professional Edition of *Your Income Tax 2017*

Tax alert symbols. Throughout the text of *Your Income Tax*, these special symbols alert you to advisory tips about filing your federal tax return and tax planning opportunities:

1040 *Filing Tip or Filing Instruction*...............A **Filing Tip** or **Filing Instruction** helps you prepare your 2016 return.

Planning Reminder........................A **Planning Reminder** highlights year-end tax strategies for 2016 or planning opportunities for 2017 and later years.

Caution ....A **Caution** points out potential pitfalls to avoid and areas where IRS opposition may be expected.

Law Alert..................................A **Law Alert** indicates recent changes in the tax law and pending legislation before Congress.

Court Decision.............................A **Court Decision** highlights key rulings from the Tax Court and other federal courts.

IRS Alert..................................An **IRS Alert** highlights key rulings and announcements from the IRS.

Visit www.jklasser.com for FREE download of *e-Supplement*

You can download a free *e-Supplement* to *Your Income Tax 2017* at *www.jklasser.com*. The *e-Supplement* will provide an update on tax developments from the IRS and Congress, including a look ahead to 2017.

On the homepage at *jklasser.com*, you will find free tax news, tax tips and tax planning articles, and you can sign up for a free e-newsletter.

The PROFESSIONAL EDITION of *Your Income Tax* is divided into two volumes.

Volume I includes the complete 2017 edition of *Your Income Tax*, which for 80 years has helped subscribers solve their tax problems and has proven to be a solid reference work for tax professionals.

Volume II expands the usefulness of *Your Income Tax* for tax professionals by providing citations of tax authorities and sections devoted to practice before the IRS.

VOLUME I: YOUR INCOME TAX (Parts 1–8)

This volume includes the 2017 edition of *Your Income Tax*. The contents start on page v, and the index begins on page 975.

VOLUME II: PROFESSIONAL TAX PRACTICE (Parts 9–11)

This volume includes the following technical tax information:

TAX LAW AUTHORITIES (Part 9). Here is an explanation of tax authorities—legislative, administrative, and judicial—and their relative importance in the practice of tax law. Part 9 begins on page 805.

CITATIONS OF AUTHORITY (Part 10). Here are key authorities for the text of *Your Income Tax* that can save you time and effort in researching income tax problems. The authorities cited are the Internal Revenue Code, IRS regulations and rulings, and court decisions. Part 10 begins on page 811.

PRACTICE BEFORE THE IRS (Part 11). This section discusses how to handle tax audits and obtain a ruling from the IRS. Also discussed are the Circular 230 practice requirements and tax preparer penalties. Part 11 begins on page 933.

What's New for 2016

For an update on tax developments and a free download of the *e-Supplement* to this book, visit us online at *www.jklasser.com.*

Tax News for 2016

Item—	*Highlight—*
Tax rate brackets and preferential rates for capital gains/ qualified dividends	The 10%, 15%, 25%, 28%, 33%, 35% and 39.6% brackets for 2016 ordinary income reflect an inflation adjustment. The top bracket of 39.6% applies if taxable income exceeds $415,050 for single taxpayers, $441,000 for heads of households, $466,950 for married persons filing jointly and qualifying widows/widowers, and $233,475 for married taxpayers filing separate returns *(1.2)*. Qualified dividends *(4.2)* and long-term capital gains *(5.3)* may escape tax entirely under the 0% rate, or be subject to capital gain rates of 15% or 20% depending on filing status, taxable income, and how much of the taxable income consists of qualified dividends and eligible long-term gains. The 20% capital gain rate has the same taxable income thresholds as the 39.6% ordinary income rate shown above, that is, either $415,050, $441,000, $466,950, or $233,475, depending on filing status. The 0%, 15%, and 20% rates do not apply to long-term gains subject to the 28% rate (collectibles and taxed portion of small business stock) or the 25% rate for unrecaptured real estate depreciation *(5.3)*.
Individual health care mandate and premium tax credit	You are required to have minimum essential health coverage through an employer plan, a government program, or other plan, or pay a penalty *(38.5)*, unless you are exempt from this requirement *(38.6)*. The penalty amount for 2016 is the higher of (1) 2.5% of household income above your filing threshold, or (2) $695 per person in your household ($347.50 per dependent child under age 18), up to a maximum of $2,085. To help those of modest means pay premiums for coverage obtained from a government exchange (Marketplace), there's a premium tax credit *(25.12)*. Eligibility for this advanceable, refundable tax credit depends on your household income and other factors. If you claimed the credit in advance when you obtained coverage, you have to reconcile what you already applied toward your premiums with what you are actually entitled to; the difference is reported on your tax return *(25.12)*. If you did not receive the credit in advance but are eligible for a credit, you can claim it on your return. If you do not claim the premium tax credit and qualify for Trade Adjustment Assistance (TAA), you may qualify for the health coverage tax credit of 72.5% of premiums *(25.13)*.
Phaseout of personal exemptions and itemized deductions	Personal exemptions and itemized deductions are subject to a phaseout. Each $4,050 personal exemption for 2016 is subject to a phaseout if adjusted gross income (AGI) exceeds $311,300 if married filing jointly or qualifying widow/widower, $285,350 if head of household, $259,400 if single, and $155,650 if married filing separately. Phaseout details are at *21.12*. The above AGI phaseout thresholds for exemptions also apply to the phaseout of itemized deductions claimed on Schedule A (Form 1040), but there is no phaseout of deductions for medical expenses, investment interest, casualty/theft losses, and gambling losses. Other itemized deductions are reduced by 3% of AGI exceeding the applicable threshold, but the total reduction cannot exceed 80% of the deductions *(13.7)*.
Standard deductions	The standard deduction for 2016 *(13.1)* is $12,600 for married persons filing jointly and qualifying widows/widowers, $9,300 for heads of households, or $6,300 for single taxpayers or married persons filing separately. The additional standard deduction *(13.4)* for being 65 or older or blind is $1,550 if single or head of household ($3,100 if 65 and blind). If married filing jointly, the additional standard deduction is $1,250 if one spouse is 65 or older or blind, $2,500 if both spouses are at least 65 (or one is 65 and blind, or both are blind and under age 65).

Tax News for 2016

Item—	*Highlight—*
Mortgage interest limit for unmarried co-owners	An appeals court held that if unmarried individuals co-own a residence, each co-owner can deduct interest on acquisition debt of up to $1 million and home equity debt up to $100,000. This decision disagreed with the Tax Court view that the $1.1 million debt limit must be divided among the co-owners; the IRS has agreed to follow the appeals court decision *(15.2)*.
Basis of property reported on estate tax return	Executors filing estate tax returns after July 31, 2015, must report the date-of-death value of property included in the gross estate to the IRS and to the heirs. The heirs may be subject to a penalty if on a later sale of the property, they claim a basis for the property that exceeds the amount that had been reported to the IRS by the executor *(5.17)*.
Self-employment tax and deduction for portion of self-employment tax; Social Security wage base	For 2016, the tax rate on the employee portion of Social Security is 6.2% on wages up to $118,500, so Social Security tax withholdings should not exceed $7,347. Medicare tax of 1.45% is withheld from all wages regardless of amount. On Schedule SE for 2016, self-employment tax of 15.3% applies to earnings of up to $118,500 after the earnings are reduced by 7.65%. The 15.3% rate equals 12.4% for Social Security (6.2% employee share and 6.2% employer share) plus 2.9% for Medicare. If net earnings exceed $118,500, the 2.9% Medicare rate applies to the entire amount *(45.3–45.4)*. One half of the self-employment tax may be claimed as an above-the-line deduction on Form 1040 *(45.3–45.4)*.
IRA and Roth IRA contribution phaseout; rollover limits	For 2016, the contribution limit for traditional IRAs *(8.2)* and Roth IRAs *(8.20)* is unchanged at $5,500, or $6,500 for those age 50 or older. The deduction limit for 2016 contributions to a traditional IRA is phased out *(8.4)* for active plan participants with modified AGI (MAGI) between $61,000 and $71,000 for a single person or head of household, or between $98,000 and $118,000 for married persons filing jointly and qualifying widows/widowers. The phaseout range is $184,000 – $194,000 for a spouse who is not an active plan participant and who files jointly with a spouse who is an active plan participant. The 2016 Roth IRA contribution limit is phased out *(8.20)* for a single person or head of household with MAGI between $117,000 and $132,000, and for married persons filing jointly and qualifying widows/widowers with MAGI between $184,000 and $194,000. You can make only one IRA rollover (60-day rollover) every 12 months *(8.10)*. There is no restriction on the number of direct transfers you can make each year. If you miss the 60-day deadline because of an event specified in Revenue Procedure 2016-47, you can complete the rollover by self-certifying your eligibility for this relief *(8.10)*.
First-year expensing	For qualifying property placed in service in 2016, first-year expensing *(42.3)* is allowed up to a limit of $500,000, and the limit begins to phase out if the total cost of qualifying property exceeds $2,010,000 *(42.3)*.
IRS mileage allowance	The IRS standard business mileage rate for 2016 is 54 cents a mile *(43.1)*. The rate for medical expense *(17.9)* and moving expense *(12.3)* deductions is 19 cents a mile . For charitable volunteers *(14.4)*, the mileage rate is unchanged at 14 cents a mile.
Vehicle depreciation limit	For a car placed in service in 2016, the first-year depreciation limit is $3,160 *(43.5)*. For a light truck or van, the first-year depreciation limit is $3,560 *(43.5)*. These first-year limits are increased by $8,000 for vehicles purchased new and used over 50% for business in 2016.
Health savings accounts (HSAs)	The definition of a high-deductible health plan, which is a prerequisite to funding an HSA, means a policy with a minimum deductible for 2016 of $1,300 for self-only coverage and a maximum out-of-pocket cap on co-payments and other amounts of $6,550. These limits are doubled for family coverage ($2,600/$13,100) *(41.10)*. The contribution for 2016 is capped at $3,350 for self-only coverage and $6,750 for family coverage *(41.11)*.

Tax News for 2016

Item—	*Highlight—*
Adoption expenses	For 2016, the limit on the adoption credit as well as the exclusion for employer-paid adoption assistance is $13,460. The benefit phaseout range is modified adjusted gross income between $201,920 to $241,920 *(25.8)*.
Earned income tax credit	For 2016, the maximum credit amount is $3,373 for one qualifying child, $5,572 for two qualifying children, $6,269 for three or more qualifying children, and $506 for taxpayers who have no qualifying child *(25.6)*. The phaseout ranges for the credit have been adjusted for inflation *(25.7)*.
Alternative minimum tax (AMT) exemption and tax brackets	The AMT exemptions, exemption phaseout thresholds, and the dividing line between the 26% and 28% AMT brackets are adjusted for inflation. The 2016 AMT exemptions (prior to any phaseout) are $83,800 for married couples filing jointly and qualifying widows/widowers, $53,900 for single persons and heads of households, and $41,900 for married persons filing separately. *See 23.1* for exemption phaseout rules and AMT calculation details. All nonrefundable personal credits for may be claimed against the AMT as well as the regular tax *(23.3)*.
Eligibility for saver's credit	The adjusted gross income brackets for the 10%, 20%, and 50% credits are increased for 2016. No credit is allowed when AGI exceeds $30,750 for single taxpayers, $46,125 for heads of households, and $61,500 for married persons filing jointly *(25.11)*.
Deduction limits for long-term care premiums	The maximum amount of age-based long-term care premiums that can be included as deductible medical expenses for 2016 (subject to the 7.5% or 10% of AGI floor; *see 17.1*) is $390 if you are age 40 or younger at the end of 2016; $730 for those age 41 through 50; $1,460 for those age 51 through 60; $3,900 for those age 61 through 70; and $4,870 for those over age 70 *(17.15)*.
Foreign earned income and housing exclusions	The maximum foreign earned income exclusion for 2016 is $101,300 *(36.1)*. The limit on housing expenses that may be taken into account in figuring the housing exclusion is generally $30,390, but the limit is increased by the IRS for high cost localities *(36.4)*.
Annual gift tax exclusion; Gift tax and estate tax exemption	The annual gift tax exclusion stays at $14,000 per donee for 2016 gifts of cash or present interests *(39.2)*. The basic exemption amount for 2016 gift tax and estate tax purposes is $5,450,000 *(39.4, 39.9)*. The top tax rate remains at 40% *(39.9)*.

Key Tax Numbers for 2016

Exemptions	
Each allowable exemption *(21.1)*	$ 4,050
Phaseout starts/ends *(21.12)*	
Joint return/Qualifying widow/widower	$301,300/$433,800
Head of Household	$285,350/$407,850
Single	$259,400/$381,9000
Married filing separately	$155,650/$216,900
Standard Deduction *(13.1)*	
Joint return/Qualifying widow/widower	$ 12,600
Head of Household	$ 9,300
Single	$ 6,300
Married filing separately	$ 6,300
Dependents-minimum deduction *(13.5)*	$ 1,050
Additional deduction if age 65 or older, or blind *(13.4)*	
Married-per spouse, filing jointly or separately	$ 1,250 ($2,500 for age and blindness)
Qualifying widow/widower	$ 1,250 ($2,500 for age and blindness)
Single or head of household	$ 1,550 ($3,100 for age and blindness)
Long-term Care Premiums *(17.15)*	
Limit on premium allowed as medical expense	
Age 40 or under	$ 390
Over 40 but not over 50	$ 730
Over 50 but not over 60	$ 1,460
Over 60 but not over 70	$ 3,900
Over 70	$ 4,870
IRA Contributions	
Traditional IRA contribution limit *(8.2)*	$ 5,500
Additional contribution if age 50 or older but under 70½	$ 1,000
Deduction phaseout for active plan participant *(8.4)*	
Single or head of household	$ 61,000 – $ 71,000
Married filing jointly, two participants	$ 98,000 – $ 118,000
Married filing jointly, one participant	
Participant spouse	$ 98,000 – $ 118,000
Non-participant spouse	$ 184,000 – $ 194,000
Married filing separately, live together, either participates	$ 0 – $ 10,000
Married filing separately, live apart all year	
Participant spouse	$ 61,000 – $ 71,000
Non-participant spouse	no phaseout
Roth IRA contribution limit *(8.20)*	$ 5,500
Additional contribution if age 50 or older but under 70½	$ 1,000
Contribution limit phaseout range	
Single, head of household	$ 117,000 – $ 132,000
Married filing separately, live apart all year	$ 117,000 – $ 132,000
Married filing jointly, or qualifying widow/widower	$ 184,000 – $ 194,000
Married filing separately, live together at any time	$ 0 – $ 10,000
Elective deferral limits	
401(k), 403(b), 457 plans *(7.16)*	$ 18,000
Salary-reduction SEP *(8.16)*	$ 18,000
SIMPLE IRA *(8.17)*	$ 12,500

Elective deferral limits *(continued)*

Additional contribution if age 50 or older ("catch-up" contributions)	
401(k), 403(b), governmental 457 and SEP plans *(7.16, 8.16)*	$ 6,000
SIMPLE IRA *(8.17)*	$ 3,000

Education

American Opportunity credit limit-per student *(33.8)*	$2,500
Lifetime Learning credit limit-per taxpayer *(33.9)*	$2,000
Phaseout of American Opportunity credit *(33.8)*	
Married filing jointly	$ 160,000–$ 180,000
Single, head of household, or qualifying widow/widower	$80,000–$ 90,000
Phaseout of Lifetime Learning credit *(33.9)*	
Married filing jointly	$ 111,000–$ 131,000
Single, head of household, or qualifying widow/widower	$ 55,000–$ 65,000
Student loan interest deduction limit *(33.13)*	$2,500
Phaseout of deduction limit	
Married filing jointly	$130,000–$160,000
Single, head of household, or qualifying widow/widower	$65,000–$80,000
Coverdell ESA limit *(33.10)*	$2,000
Phaseout of limit	
Married filing jointly	$190,000–$220,000
All others	$95,000–$110,000
Tuition and fees deduction *(33.12)*	
Tuition and fees deduction-tier 1 limit	$4,000
Income cut-off	
• Married filing jointly	$130,000
• Single, head of household, or qualifying widow/widower	$65,000
Tuition and fees deduction limit-tier 2 limit	$2,000
Income cut-off	
• Married filing jointly	$160,000
• Single, head of household, or qualifying widow/widower	$80,000

Capital gain rates-assets held over one year *(5.3)*

If otherwise subject to regular 10% or 15% rate	0%
If otherwise subject to regular rates over 15% but below 39.6%	15%
If otherwise subject to regular rate of 39.6%	20%
Collectibles gain-maximum rate	28%
Unrecaptured Section 1250 gain on depreciated real estate-maximum rate	25%

Qualified dividends tax rate *(4.2)*

If otherwise subject to regular 10% or 15% rate	0%
If otherwise subject to regular rates over 15% but below 39.6%	15%
If otherwise subject to regular rate of 39.6%	20%

IRS mileage rates

Business *(43.1)*	54 cents/mile
Medical *(17.9)* and Moving *(12.3)*	19 cents/mile
Charitable volunteers *(14.4)*	14 cents/mile

Exclusion for employer provided transportation *(3.8)*

Free parking, transit passes, and van pooling	$255/month
Qualified bicycle commuting	$ 20/ month

Tax-Saving Opportunities	
Objective—	*Explanation—*
Realizing long-term capital gains	Long-term capital gains are taxed at lower rates than short-term gains and regular income. *See Chapter 5* for basic capital gain rules. *See Chapters 30* and *31* for discussions of special investment situations.
Earning qualifying dividends	Qualified dividends *(4.2)* are subject to the reduced tax rates for long-term capital gains.
Earning tax-free income	You can earn tax-free income by— 1. Investing in tax-exempt securities. However, before you invest, determine whether the tax-free return will exceed the after-tax return of taxed income *(30.10)*. 2. Taking a position in a company that pays tax-free fringe benefits, such as health and life insurance protection. For a complete discussion of tax-free fringe benefits, *see Chapter 3*. 3. Seeking tax-free education benefits with scholarship arrangements, qualified tuition programs and Coverdell ESAs; *see Chapter 33*. 4. Taking a position overseas to earn excludable foreign earned income; *see Chapter 36*. 5. Investing in Roth IRAs; *see Chapter 8*.
Deferring income	You can defer income to years when you will pay less tax through— 1. Deferred pay plans, which are discussed in *Chapter 2*. 2. Qualified retirement plans such as 401(k) plans *(Chapter 7)*, self-employed plan *(Chapter 41)*, and traditional IRA and Roth IRA plans *(Chapter 8)*. 3. Transacting installment sales when you sell property; *see 5.21*. 4. Investing in U.S. Savings EE bonds or I-bonds *(4.28–4.29, 30.12–30.13)*.
Income splitting	Through income splitting you divide your income among several persons or taxpaying entities that will pay an aggregate tax lower than the tax that you would pay if you reported all of the income. Although the tax law limits income-splitting opportunities, certain business and family income planning through the use of trusts and custodian accounts can provide tax savings; *see* Chapters 24 and 39.
Tax-free exchanges	You can defer tax on appreciated property by transacting tax-free exchanges *(6.1, 31.3)*.
Buying a personal residence	Homeowners are favored by the tax law. 1. If you buy a home, condominium, or cooperative apartment, you may deduct mortgage interest *(15.2)* and taxes *(16.4)*. When you sell your principal residence, you may be able to avoid tax on gains of up to $250,000 if single and up to $500,000 if married filing jointly; *see Chapter 29*. 2. Homeowners can borrow on their home equity and deduct interest expenses within limits *(15.3)*.
Take advantage of special personal tax breaks for education	The tax law provides several breaks for education expenses; *see Chapter 33*, which discusses scholarships, grants, tuition plans, savings bond tuition plans, education credits, Coverdell Education Savings Accounts, and student loan interest deduction.
Take advantage of special tax breaks for health care expenses	The tax law provides several breaks for health care expenses. Employer-provided health and accident plans, including flexible spending arrangements, are discussed in *Chapter 3*. Health savings accounts (HSAs) can be used to save for health care expenses on a tax-free basis *(3.2, 41.10)*. ABLE accounts can be set up for individuals who become disabled before age 26 persons and be used to build up a fund from which tax-free distributions for qualified expenses can be made*(34.12)*. You may be able to qualify for the premium tax credit to help offset the cost of premiums for coverage obtained through the government Marketplace *(25.12)*.
Take advantage of personal tax credits	*See Chapter 25* for personal tax credits such as the premium tax credit, child tax credit, dependent care credit, saver's credit and adoption credit that can reduce your tax liability.

Contents Chapter by Chapter