2016-2017 TAX UPDATE

Tax Season Starting and Due Date for 2017.

The IRS will start accepting tax returns on January 23, 2017. The tax day deadline will be April 18.

Taxpayers expecting refunds from the Earned Income Tax Credit and the Additional Child Tax Credit will have to wait until February 15. The IRS wishes taxpayers to be aware it will take several days for these tax refunds to be released and processed through financial institutions. Factoring in weekends and the Presidentôs Day holiday, the IRS is warning many affected taxpayers may not have actual access to their tax refunds until the week of February 27.

2017 Due Date for Forms W-2 and Form 1099r and 1099-MISC.

Under a new law, the Protecting Americans from Tax Hikes (PATH) Act, the new filing deadline for employers to submit forms W-2 to the Social Security Administration in 2017, is January 31. The new January 31 filing deadline also applies to Form 1099-R and Form 1099-MISC. The January 31 deadline for employers to furnish copies of tax forms to employees remains unchanged.

The new law also changes the rules for extending time to file Forms W-2. Now, taxpayers can only request one 30-day extension to file form W-2, and it is *not* automatic. If they need an extension, form 8809, *Application for Extension of Time to File Information Returns,* is required. The form should be completed as soon as the employers know an extension is necessary, but no later than January 31.

Paper or e-filing requirement. Employers will have to follow the following filing requirement:

- 249 or fewer returns per year (Federal Copy A) are permitted to be filed electronically or by paper by January 31st.
- 250 or more returns per year (Federal Copy A) must be filed electronically by January 31st.

New Income Tax Returns Due Dates: Effective for 2017 Filing Season.

Second, the new federal due dates apply to 2016 tax returns and the 2017 filing season and beyond. However, it should be noted that the new rules apply to tax years beginning after Dec. 31, 2015, so they will apply to short-year returns beginning in 2016, before the general 2017 filing season. For example, if during its tax year beginning in 2016, a partnership has a technical termination or a corporation goes out of existence or changes its tax year sometime in 2016, the new due dates would apply to the entity's short-period return.

Below is a list of the new federal due dates generally applicable for 2016 tax returns (2017 filing season) and beyond.

March 15 (Extensions until Sept. 15)

- Form 1065, *U.S. Return of Partnership Income*; and
- Form 1120S, *U.S. Income Tax Return for an S Corporation*.

April 15 (Extensions until Oct. 15, Unless Noted Below)

- Form 1040, *U.S. Individual Income Tax Return*;
- Form 1041, *U.S. Income Tax Return for Estates and Trusts* (extensions until Sept. 30);
- Form 1120, *U.S. Corporation Income Tax Return* (extensions until Sept. 15 until 2026, see note below); and
- FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR) (any late filing penalty for a first-time filer may be waived).

Note: Calendar-year C corporations can get extensions until Sept. 15 until tax years beginning after 2025 when the extended due date will be Oct. 15. June 30 fiscal-year-end C corporations (returns due Sept. 15) can get extensions to April 15 until tax years beginning after 2025; after 2025, June 30 fiscal-year-end C corporations will have an Oct. 15 due date and can get extensions until April 15.

May 15 (Extensions Until Nov. 15)

- Form 990, *Return of Organization Exempt From Income Tax* (series).

July 31 (Extensions Until Oct. 15)

- Form 5500 for employee benefit plans.

Note: The Form 5500 extension due date of Oct. 15 remains unchanged.

Other Forms That May Be Affected.

Although the legislation does not go into detail about due dates for various other forms, it should be noted that forms that are tied to the due dates of the above forms will need to be revised accordingly. For example, Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, will likely be changed to coincide with the corresponding return's new due date. Some other forms that are likely to be changed to go along with the corresponding return's new due date are:

- Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*;
- Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code)*;
- Form 8804, *Annual Return for Partnership Withholding Tax (Section 1446)*;
- Form 8805, *Foreign Partner's Information Statement of Section 1446 Withholding Tax*;
- Form 8858, *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities*;
- Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*; and
- Form 8886, *Reportable Transaction Disclosure Statement.*

New Due Diligence Requirement for 2017.

The PATH Act expanded the preparer due diligence requirements that originally applied to returns claiming an Earned Income Tax Credit (EITC), first added by Taxpayer Relief Act of 1997, to apply to returns claiming the Child Tax Credit (CTC), Additional Child Tax Credit (ACTC) and American Opportunity Tax Credit (AOTC).

The tax return paid preparer will meet the due diligence requirements if the paid preparer does all of the following:

1) Completes Form 8867 truthfully and accurately and completes the actions described on Form 8867 for each credit claimed.
2) Submits Form 8867 in the manner required.
3) Meets the knowledge requirement by interviewing the taxpayer, asking adequate questions, documenting the taxpayer’s responses on the return or in notes, reviewing adequate information to determine if the taxpayer is eligible to claim the credit(s) and in what amount(s), and
4) Keeps all five of the following records for three years from the latest of either the due date of the tax return (not including extensions), the date the return was filed, the date the return was presented to the taxpayer for signature, or the date submitted to the signing tax return preparer the part of the return for which the paid preparer was responsible (if the paid preparer is a non-signing tax return preparer).
    a. A copy of Form 8867,
    b. The applicable worksheet(s) for any credits claimed,
    c. Copies of any taxpayer documents the paid preparer may have relied upon to determine eligibility for and the amount of the credit(s),
    d. A record of how, when, and from whom the information used to prepare Form 8867 and worksheet(s) was obtained, and
    e. A record of any additional questions the paid preparer may have asked to determine eligibility for and the amount of the credits, and the taxpayer’s answers.

Requirements for the Child Tax Credit and Additional Child Tax Credit. In addition to all of the due diligence questions on Form 8867 for the EIC (which appear on previous tax year Forms 8867), the new questions specific for the Child Tax Credit (and/or additional Child Tax Credit) are:

- Does the child reside with the taxpayer who is claiming the CTC/ACTC?
- If the child does not reside with the taxpayer, did the paid preparer ask if there is an active Form 8332, *Release/Revocation of Claim to Exemption for Child by Custodial Parent,* or a similar statement in place and, is it attached to the return?
- If the child does reside with the taxpayer, has the paid preparer determined that the taxpayer has not released the claim to another person?

If the taxpayer is the noncustodial parent and has a Form 8332 (or equivalent document) signed by the custodial parent, the paid preparer must ask the taxpayer if there is a more recent form revoking the release of the exemption. Simply having a copy of Form 8332 may not be enough to satisfy this due diligence requirement.

New due diligence questions for returns claiming the AOTC. The new Form 8867 also contains an additional question to ask taxpayers who are claiming the American Opportunity Tax Credit (AOTC). The question is:

- Did the taxpayer provide substantiation such as a Form 1098-T and receipts for the qualified tuition and related expenses for the claimed AOTC?

The question does not ask for either Form 1098-T or receipts. The question asks for both a Form 1098-T and receipts for qualified tuition and related expenses. Simply having a copy of Form 1098-T may not be enough to satisfy this due diligence requirement.

Issues and requirements of Form 1098-T. For several educational institutions, compliance with Form 1098-T reporting requirements was very problematic. For filing season 2017, taxpayers can take the AOTC base on the amount actually paid not on the amount billed by the institution.

The issue for some schools is that the accounting software was not originally designed to comply with the IRS requirements. Thus, reporting issues related to undesignated payments and reimbursements, inability to allocate student payments to specified expenses and netting amounts billed or paid were inconsistent among institutions for 2016. The intent of Congress was for taxpayers to only take the tax credits or deductions based on qualified expenses actually paid, not billed. Thus, given the complexity and reporting issue, the IRS did not impose penalties in regards to the amounts reported on Form 1098-T for 2016.

For 2017, it is expected that the IRS will assess penalties for non-compliance. Therefore, educational institutions should report only amounts actually paid for qualified expenses. As a result, calculating these credits and deductions will be more accurate in 2017.

Exemption for Form 1098-t. For the Form 1098-T to be accurately prepared, the educational institution must address boxes 8 and 9. Note that box 8 will be checked if the student was enrolled at least half-time, and box 9 will be checked if the student was enrolled as a graduate student. There are some exceptions where an educational institution is not required to file and provide the Form 1098-T. These exceptions include:

- Courses for which no academic credit is offered, even if the student is otherwise enrolled in a degree program.
- Nonresident alien students, unless the student requests the institution to file Form 1098-T.
- Students whose tuition and related expenses are waived entirely or paid entirely with scholarships or grants.
- Students whose tuition and related expenses are covered by a formal billing arrangement with the studentÕs employer or a government agency such as the Department of Veterans Affairs or the Department of Defense.

Penalties under the new due diligence requirements. The regulations were also amended to reflect other legislative changes that subject the penalty amount to an inflation adjustment. The

$500 penalty for each breach of the rules, which applies separately to each credit, is adjusted for inflation. For 2016 and 2017, the inflation-adjusted penalty is $510.

There is potential for a $1,530 per return penalty for the three credits (CTC and ACTC are treated as one credit). It should also be noted that the IRS usually imposes the penalty for failure to meet the due diligence requirements on all tax returns claiming a credit prepared by the paid preparer. The IRS generally assumes a paid preparer's procedure for filing one return is the same as the procedures for filing all returns so that a failure on one return is generally a failure on all returns prepared by that preparer.

Medical expenses base of 10% for everyone.

For the vast majority of Americans in 2016, their medical expenses would have to surpass 10% of their adjusted gross income (AGI) in order to take a deduction. However, taxpayers 65 and older were able to use a previous threshold of just 7.5% of their AGI when itemizing and taking a deduction in 2016. Beginning in 2017, everyone is required to deduct expenses after exceeding 10% of their AGI.

Health Coverage Penalty for 2017.

For 2017, the dollar amount used to calculate the individual shared responsibility penalty for neglecting to maintain minimum essential health coverage is set at $695 or 2.5% of household income, whichever is higher.

IRA Contribution Limits for 2017.

- Taxpayers can defer a maximum of $18,000 of their salary to a 401(k) plan (Same as 2016).
- They can contribute a maximum of $5,500 to their Roth or traditional IRA (same as 2016).
- If they are age 50 or older, they can use the catch-up contribution to save an additional $6,000 in your 401(k).
- If they are age 50 or older, they can use the catch-up contribution to save an additional $1,000 in their IRA.
- They can contribute to a Roth IRA if they meet one of these conditions: earn less than $133,000 and are filing single; earn less than $196,000 and are married filing jointly; earn less than $10,000 and are married filing separately.

In order to deduct IRA contributions for 2017 taxpayers:

- Do not have access to a retirement plan through your employer and are under age 70 ½.
- Have access to a retirement plan at work and your adjusted gross income (AGI) is $119,000 or less for couples or $72,000 or less for singles.
- Do not have access to a retirement plan through your employer but your spouse does. In this case, you may be able to make a partial deduction in the event that you file a joint return, and your adjusted gross income (AGI) is $196,000 or less.

Form 1098 New Requirements.

A new tax provision requires Forms 1908 to report the origination date of a mortgage, the property address for the collateral and outstanding balance on the loan at the beginning of the tax year. It is estimated it will raise an additional $1.8 billion for the government over ten years.

The new reporting elements go into effect for the tax year 2017 so lenders and servicers do not have to report the new data elements to the borrower and IRS until January 2018.

FAFSA Changes release pressure on 2016 income tax returns.

Starting with the 2017ï 18 *Free Application for Federal Student Aid* (FAFSA), the following changes have been put in place:

- **Students are now able to submit an FAFSA earlier.** Students have been able to file a 2017ï 18 FAFSA since Oct. 1, 2016, rather than beginning on Jan. 1, 2017. The earlier submission date is a permanent change, enabling students to complete and submit an FAFSA as early as Oct. 1 every year.
- **Students now report earlier income information.** Beginning with the 2017ï 18 FAFSA, students are required to report income information from an earlier tax year. For example, on the 2017ï 18 FAFSA, students (and parents, as appropriate) must report their 2015 income information, rather than their 2016 income information.

This will enable taxpayers to have more time and less pressure to file their income tax return for 2016 taxable year.

Benefits of these changes:

- Taxpayers will not need to estimate their tax information and then go back into the FAFSA to update it once the return is ready.
- Taxpayers will be able to use the IRS Data Retrieval Tool (IRS DRT) to import their tax information into their FAFSA automatically.

Taxpayers will be able to provide their most current information that could benefit their application. The FAFSA application will allow them to provide the 2016 information and make the proper addition or subtraction to the 2015 reported income.

Payroll changes in 2017. The maximum amount of earnings subject to the Social Security payroll tax will climb 7.3 percent in 2017. The new amount subject to Social Security tax will be $127,200ð up by $8,700 from the $118,500 maximum for 2016 and 2015.

ITIN Renewal Reminder.

ITINs are used by people who have tax-filing or payment obligations under U.S. law but are not eligible for a Social Security number. Under a recent change in law, any ITIN not used on a tax return at least once in the past three years will expire on Jan. 1, 2017. In addition, any ITIN with middle digits of either 78 or 79 (9NN-78-NNNN or 9NN-79-NNNN) will also expire on that date.

This means that anyone with an expiring ITIN and need to file a tax return in the upcoming filing season should file a renewal application in the next few weeks to avoid lengthy refund and processing delays. Failure to renew early could result in refund delays and denial of some tax benefits until the ITIN is renewed.

An ITIN renewal application filed now will be processed before one submitted at the height of tax season from mid-January to February. Currently, a complete and accurate renewal application can be processed in as little as seven weeks. But this timeframe is expected to expand to as much as 11 weeks during tax season, which runs from mid-January through April.
Several common errors are currently slowing down or holding up ITIN renewal applications. The mistakes generally center on missing information, and/or insufficient supporting documentation.

Warnings on Phishing Scams.

IRS officials warn taxpayers to be alert to phone and email phishing scams that try to trick victims into divulging their personal information or forcing them to make a payment over the phone.

The IRS says it has been working with the tax industry and state revenue departments to continue strengthening processing systems to protect taxpayers from identity theft and refund fraud.

Scammers will call or email taxpayers to verify the last four digits of their Social Security number by clicking on a link provided in an email, which claims that recent data breaches across the nation may be involved. They have also received notices from taxpayers experiencing fake IRS calls in which they are forced to pay for fake income tax overdue accounts.

Government offices do not send emails like this, authorities said. They do not call to force taxpayers to pay over the phone. Taxpayers should not reply to emails or phone calls requesting confidential information, especially the Social Security number, birth date, salary information or home address.

Safeguarding Taxpayers Data.

Best practices to protect taxpayers and tax preparer data include:

- Take responsibility or assign someone to be responsible for safeguards;
- Assess the risks to taxpayer information in the office. Make sure to include the operations, physical environment, computer systems and employees, if applicable;
- Make a list of the locations where the taxpayersô information is kept (computers, filing cabinets, and containers taxpayers may bring to the office);
- Write a plan of how to safeguard taxpayer information. Put appropriate safeguards in place;
- Use service providers who have policies to maintain an adequate level of information protection; and
- Monitor, evaluate and adjust the security program as the business or circumstances change.

To safeguard taxpayer information, determine the appropriate security controls for the office based on the size, complexity, nature and scope of the activities. Security controls are the management, operational and technical safeguards tax professionals may use to protect the confidentiality, integrity, and availability of their customersô information.

Examples of security controls include:

- Locking doors to restrict access to paper or electronic files
- Requiring passwords to restrict access to computer files
- Encrypting electronically stored taxpayer data
- Keeping a backup of electronic data for recovery purposes
- Shredding paper containing taxpayer information
- Removing sensitive or personal information before mailing items

IRS Launching New Education Provider Website.

The IRS started moving their education provider internet service to a new site. As a result, no CE completed after September 11, 2016, has been added to PTIN accounts. The system is expected to be operational soon. They sent notices apologizing for the extended delay. As of December 21, 2016, the Provider System was not ready yet.

Tax professionals do not need to wait in order to renew their PTIN. They can go back to accept Circular 230 terms and be listed on the IRS website.

CALIFORNIA TAX CHANGES.

Head of Household Requirement Reminder. For the tax year 2016, taxpayers claiming the head of household filing status are required to attach form FTB 3532, Head of Household Filing Status Schedule to their tax return. In late October, the FTB began mailing the following letters:

- HOH demand letters
- HOH Education letters
- HOH Information Document Request (IDR) letters

Taxpayers who did not attach the schedule to their return may receive either an HOH education letter or HOH audit demand letter. The HOH education letter reminds taxpayers to attach form FTB 3532 to their 2016 tax return if they claim the head of household filing status, while the demand letter requests they submit the missing schedule.

If any tax client received an HOH audit demand letter, advise them to respond by the letterôs due date to avoid the Failure to Furnish Information penalty.

If taxpayers determine they do not qualify for the HOH filing status, they should mark the ñI do not qualify for head of householdò box on the top of the HOH information request letter.
The HOH audit staff will review the form FTB 3532 and related documentation to determine if taxpayers qualify for the HOH filing status. If the questionnaire is incomplete or provides conflicting information, the FTB may contact the taxpayer to resolve the issue. Once the

information is confirmed, the FTB will send an acceptance letter to the taxpayer. The tax-year specific acceptance letters only apply to the specific tax year examined and do not qualify the taxpayer for other tax years.

Taxpayers who fail to respond to the letters or whose responses indicate they do not qualify for HOH can expect a Notice of Proposed Assessment disallowing their HOH filing status.

Sales Tax Reduction in 2017.

Both local and state sales tax rate changes are set to take effect in California on January 1, 2017. The state sales and use tax rate will drop from the current rate of 7.5% to 7.25%. This change is due to voter approval of Proposition 30, which imposed a temporary 0.25% sales tax from January 1, 2013, through December 31, 2016.

In addition, the local sales and use tax rate for the City of Long Beach will increase by 0.75%. This will bring the combined state and local rate for Long Beach to 9.75%.

Netflix Sales Tax.

Streaming services such as those provided by Netflix, Hulu, and HBO Go will be subject to sales tax in Pasadena, California, beginning January 1, 2017. Pasadena is not the first city to specifically tax these; they have been subject to tax in Chicago, Illinois since July 1, 2015, and it is unlikely to be the last. A number of other cities in California ð including San Bernardino and Santa Monica ð are being advised to collect tax on streaming services.

CALIFORNIA INCOME TAX FIGURES FOR 2016 TAX YEAR.

California Personal Exemption credits.

Filing Status/Qualification	Exemption amount
Married/Registered Domestic Partner (RDP) filing jointly or qualifying widow(er)	$222
Single, married/RDP filing separately, or head of household	$111
Dependent	$344
Blind	$111
Age 65 or older	$111

Phaseout of exemption credits. Higher-income taxpayers' exemption credits are reduced as follows:

Filing status	Reduce each credit by:	For each:	Federal AGI exceeds:
Single	$6	$2,500	$182,459
Married/RDP filing separately	$6	$1,250	$182,459
Head of household	$6	$2,500	$273,692
Married/RDP filing jointly	$12	$2,500	$364,923
Qualifying widow(er)	$12	$2,500	$364,923

When applying the phaseout amount, apply the $6/$12 amount to each exemption credit, but do not reduce the credit below zero. If a personal exemption credit is less than the phaseout amount, do not apply the excess against a dependent exemption credit.

The standard deduction amounts for:

Filing status	Deduction amount
Single or married/RDP filing separately	$4,129
Married/RDP filing jointly, head of household, or qualifying widow(er)	$8,258
The minimum standard deduction for dependents	$1,050

Earned Income Tax Credit. The California earned income tax credit is available to California households with federal adjusted gross income (AGI) of:

- Less than $6,718 if there are no qualifying children.
- Less than $10,088 if there is one qualifying child.
- Less than $14,162 if there are two or more qualifying children.

The maximum amount of investment income to remain eligible for the credit is $3,471.

Nonrefundable Renter's Credit. This nonrefundable, non-carryover credit for renters is available for:

- Single or married/RDP filing separately with a California AGI of $39,062 or less.
  - The credit is $60.
- Married/RDP filing jointly, head of household, or qualifying widow(er) with a California AGI of $78,125 or less.
  - The credit is $120.

Individual Filing Requirements. If taxpayers gross income or adjusted gross income is more than the amount shown in the chart below for taxpayersô filing status, age, and number of dependents, then they have a filing requirement.

Filing Status	Age as of December 31, 2016*	California Gross Income			California Adjusted Gross Income		
		Dependents			Dependents		
		0	1	2 or more	0	1	2 or more
Single or head of household	Under 65	$16,597	$28,064	$36,664	$13,278	$24,745	$33,345
	65 or older	$22,147	$30,747	$37,627	$18,828	$27,428	$34,308
Married/RDP filing jointly or separately	Under 65 (both spouses/RDPs)	$33,197	$44,664	$53,264	$26,558	$38,025	$46,625
	65 or older (one spouse)	$38,747	$47,347	$54,227	$32,108	$40,708	$47,588
	65 or older (both spouses/RDPs)	$44,297	$52,897	$59,777	$37,658	$46,258	$53,138
Qualifying widow(er)	Under 65	N/A	$28,064	$36,664	N/A	$24,745	$33,345
	65 or older	N/A	$30,747	$37,627	N/A	$27,428	$34,308
Dependent of another person (Any filing status)	Under 65	More than taxpayerôs standard deduction					
	65 or older	More than taxpayerôs standard deduction					

* If taxpayers turn 65 on January 1, 2017, they are considered to be age 65 at the end of 2016.

Payroll changes in California. Assembly Bill (AB) 1245 (Chapter 222, Statutes of 2015) requires all employers to electronically file their employment tax returns, reports, and payments to the Employment Development Department (EDD) beginning January 1, 20171.

Employers with 10 or more employees will become subject January 1, 2017, and all other employers will be subject January 1, 2018.

MINIMUM WAGES IN CALIFORNIA.

There is an exception for learners, regardless of age, who may be paid not less than 85 percent of the minimum wage rounded to the nearest nickel during their first 160 hours of employment in occupations in which they have no previous similar or related experience.

There are also exceptions for employees who are mentally or physically disabled or both, and for nonprofit organizations such as sheltered workshops or rehabilitation facilities that employ disabled workers. Such individuals and organizations may be issued a special license by the Division of Labor Standards Enforcement authorizing employment at a wage less than the legal minimum wage. Labor Code Sections 1191 and 1191.5

Schedule for California Minimum Wage rate 2017-2023.

Date	Minimum Wage for Employers with 25 Employees or Less	Minimum Wage for Employers with 26 Employees or More
January 1, 2017	$10.00/hour	$10.50/hour
January 1, 2018	$10.50/hour	$11.00/hour
January 1, 2019	$11.00/hour	$12.00/hour
January 1, 2020	$12.00/hour	$13.00/hour
January 1, 2021	$13.00/hour	$14.00/hour
January 1, 2022	$14.00/hour	$15.00/hour
January 1, 2023	$15.00/hour	