Katz, Look & Onorato, P.C.
Klaralee R. Charlton, Esq.
KCharlton@TheDenverLawyers.com
(303) 832-1900

2018 Tax Update for Seniors

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Filing Deadlines

Form 1040

Individual Form 1040 tax returns will be due on **April 17, 2018**. Taxpayers may request an automatic 6 month extension to file their returns; however, any tax that may be due must still be paid by April 17, 2018. Taxpayers will owe late payment penalties and interest on payment made after this date.

Filing Returns and Communicating with the IRS

Does my parent need to file income tax returns?

While it's always a good idea to file annually regardless of income, if a taxpayer's only source of income is social security or the taxpayer has no income at all, then they do not have a filing requirement. If your parent does need to file a tax return, there are many tax preparation sites sponsored by the IRS around Denver that will prepare tax returns for free. During tax season, you can call 211 and ask for a list of the VITA sites near you. Special AARP sites may also be available which specialize in income sources common for seniors.

Can I file a return or talk to the IRS on my parent's behalf?

In order to file taxes on your parent's behalf, you need a power of attorney naming you as the taxpayer's agent. The power of attorney document needs to specifically grant you the power to file taxes. It cannot be a general one page power of attorney that grants the agent any and every power. In addition, if you ever want to talk to the IRS on behalf of your parent, you'll need to complete the IRS' specific power of attorney Form 2848 and a notice of fiduciary relationship, Form 56.

Types of Income Common for Seniors

Social Security

If you or your parent receives social security, an annual statement will be mailed summarizing the benefits paid during 2017. This document should be provided to your income tax preparer. The document usually has a pink border and should not be confused with a similar document which simply contains your expected payments for 2018.

Pensions and IRAs

If you or your parent receives pension payments or withdrew monies from an IRA or 401(k), the financial institution managing the account will mail a 1099-R in February. These documents should be provided to your income tax preparer who can calculate the taxable portion of these payments.

Investments

If you or your parent owns an investment account containing stocks, bonds or mutual funds, the financial institution managing the account will mail you documents in late February or early March. These documents may include 1099-INT, 1099-DIV, or 1099-B. The forms report the total Interest and Dividends earned by your account. If you sold any assets during the year, those sales are reported on the 1099-B. CAUTION: These forms are frequently amended by the financial institution. If significant changes are made after you have already filed your income tax return, you may need to amend your return to report the changes.

MISCONCEPTTION: Not every tax document has to be mailed by the end of January. That deadline only applied to W-2s for wage employees.

Sale of a House

Tax Consequences to Selling a House

If you or your parent sold a house during 2017, you will likely receive a 1099-S from the title company. If the home appreciated in value since it was purchased, there will be gain on the sale of the home which may be subject to income tax. The seller may exclude up to $250,000 of this gain if they lived in and owned their home for at least two of the past five years. Joint filers can exclude $500,000 of gain from the sale of their home.

If you or your parent has not yet sold the home but has already moved out, plan on selling the home within three years of the date of moved out. If the home is sold after this date, the owner loses out on the $250,000 tax exclusion. Additionally, if the owner's spouse died within the past two years, the survivor may still use the full $500,000 exclusion. In Denver's real estate market, it is not uncommon to find houses purchased for $50,000 back in the 1970s which are now sold for $500,000-$600,000. The income tax on this gain can be significant.

Caution: To claim the exclusion, the original owner must be the named seller. Do not transfer the house to the children first and then sell the home. The exclusion will be lost altogether.

Consequences to Gifting House

Parents often add children to the title of their house for administrative ease. From a tax perspective, this is a mistake. First, by transferring title to a child, the $250,000 gain exclusion is lost because the child has not lived in the house for two of the past five years. Second, the child takes the parent's tax basis which means when the child sells the house, they will compare the sale price to the parent's original purchase price to calculate the taxable gain. Third, anytime a gift over $15,000 is made in a single year, the donor must file a gift tax return. Many times, parents forget to file this return when they add a child to the title of the house or sign a quit claim deed. Lastly, a very important non-tax reason to avoid transfers to children is that the transfer puts the house at risk if your child has creditors or ends up in a divorce. If the parent still lives in the house, they are putting their living situation at risk. There are alternatives other than adding a child to the deed to make administration of the home easier.

Why Not to Sell the House

If your parent doesn't need the money, it may be wise to keep the house until after your parent passes away. From a tax perspective, when a person dies, the tax basis of that person's assets is adjusted to the fair market value as of their date of death. For example, if your dad purchased his house for $50,000 and now it's worth $500,000, he has $450,000 of gain while he's alive. After he passes away, the new tax basis of the home is the current fair market value of $500,000. The family can then sell the house after his death for $500,000 at zero gain.

This is yet another reason not to transfer a house to a child shortly before a death. In the child's hands, the house receives no basis adjustment when the parent dies. This rule is true for the parent's other assets as well such as stocks and bonds which may have been purchased years ago. It is almost always better for a parent to pass away with an asset in his or her own name than to give it away shortly before death.

There are certainly many non-tax driven reasons to sell and not sell a house. And those reasons may outweigh these tax reasons. It is always a good idea to fully research and discuss the pros and cons of transferring a house before your parent signs a deed.

Income Tax Deductions

Assisted Living

The cost of assisted living is deductible if a principal reason for being in assisted living is to get medical care. If a patient with Alzheimer's needs to be supervised, then the housing and medical care costs are deductible. If a parent simply wants to live in a community where they have meals prepared for them and they happen to receive some medical care, then only the medical care is deductible and not the room and board.

If a nurse or home healthcare worker assists your parent with dressing, bathing, or taking medications in your home or your parent's home, those wages are deductible medical expenses. If the assistant also performs household chores, that portion of their wage is not deductible.

You may only deduct out of pocket expenses—not expenses paid for or reimbursed by insurance. If your parent is paying these expenses, then your parent would deduct them on their tax return. A child may deduct assisted living and medical expenses that they pay for their parent so long as the child pays over half the parent's annual support. The parent does not have to qualify as the child's dependent (see below) for these medical deductions.

Adult Day Programs

Day programs for adults may be deductible as medical expenses if the adult is considered disabled. If the adult attends the day program so that their primary caregiver i.e. child or spouse, can go to work, the caregiver may alternatively be eligible for the Dependent Care Credit. The taxpayer may only claim one or the other, so always discuss which option makes better sense for your situation with your tax preparer.

Dependent Deductions

You may claim your parent as a **dependent** on your own income tax return if you meet five tests:

1. The parent must be related to you i.e. your parent, step-parent, in-law.
2. The parent must be a U.S. Citizen or resident or Canada or Mexico.
3. The parent may not file a joint tax return unless it is solely to obtain a refund.
4. The parent cannot have gross income > $4,050 (for 2016). This sum does not include tax exempt income or social security.
5. You must provide over half your parent's support i.e. rent, food, clothing, or you must provide 10% of the support with other family members providing the other 40% of support.

**Parent does not actually have to live with you to meet all of these factors.

If you file as single or married filing separately and you pay over half the expenses for your parent, you may also be eligible to use the head of household filing status which can help if you use the standard deduction.

Tax Reform Changes

Medical Deductions

As a result of the recent tax reform, taxpayers may write off medical expenses that exceed 7.5% of their adjusted gross income for 2017 and 2018. This was already the threshold set for taxpayers over age 65, but is a slight reduction for taxpayers under 65. Starting in 2019, the threshold increases to 10% of adjusted gross income for everyone.

Standard Deduction

For 2017, the standard deduction remains similar to previous years. For 2018, the standard deduction will essentially be doubled at each filing status; however, taxpayers will no longer have personal exemptions. What this means is that fewer taxpayers will itemize because their total deductions will not exceed the standard deduction. Taxpayers with significant medical expenses, property taxes, mortgage interest, charitable deductions should still keep their receipts.