Tax Tips for the 2017 Graduate

By Ken Milani and John J. Connors

Ken Milani and John J. Connors examine aspects of the federal income tax law particularly applicable to the 2017 graduate.

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Weak or nonexistent financial literacy in America has been an issue discussed by many commentators. Income tax, in particular, is an element of people's lives that involves the unpopular combination of mathematics and money being turned over to a multi-headed "monster" (*i.e.*, federal, state, and local governments). This article is an attempt to help 2017 graduates better understand income taxes, in general, and federal income taxes, in particular.

The authors recognize that, as inexperienced preparers of federal income tax returns, many 2017 graduates may find it challenging to file a return which will result in paying the lowest possible tax. Our effort involves introducing the 2017 graduate to some common tax considerations that could be beneficial in reducing the dreaded "tax-bite."

A set of basic facts will be assumed and worked with throughout. The assumptions are:

- Current year = the year of graduation (*i.e.*, 2017)
- Salary = $4,000/month
- Commencement of Employment = July 1, 2017
- Filing Status = Single
- State and/or Local Tax Rate = 4%
- Since the job commences on July 1, the projected total salary earned during 2017 is $24,000 (*i.e.*, $4,000/month for 6 months).

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"Take-Home" Pay

A salary of $4,000 per month does not mean that a newly employed graduate will have this amount to spend each month. Several tax-related items will be deducted from each paycheck by the employer. These include federal withholding, Social Security/Medicare (also known as FICA) and, in most cases, a state income tax. As a *single* person, our assumed taxpayer will fill out a Form W-4 for the employer and probably claim *one* exemption. This will result in "take-home" pay of $3,016

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(*see* Table 7). Since income will be earned for six months, this creates an "over-withholding" situation. In other words, too much will be deducted monthly from the paycheck since the paycheck is converted to an assumed *annual* salary (*i.e.*, $48,000) and total deductions are calculated based on this elevated figure. To alleviate this situation, the 2017 graduate should claim three dependents increasing the "number of allowances" on the W-4 to four. This increases "take-home" pay by $185/month (*see* Table 7) and generates a refund when filing the return for 2017. Early in 2018 fill out a new W-4, and list "number of allowances" as one.[1]

TAX TIP #1

Avoid over-withholding in 2017 by increasing the "number of allowances" on Form W-4. Remember to change to the proper "number of allowances" at the beginning of 2018.

Expected Refund

If Tax Tip #1 is followed, there is an excellent chance that our taxpayer will still qualify for a refund of federal income taxes when filing a 2017 tax return. If all of the graduate's income is from the job, the federal income tax liability will be approximately $1,565.[2] Since his or her employer withheld $1,998 (6 × $333/month per Table 7), he or she will be eligible for a tax refund.

TAX TIP #2

Be prepared to file the 2017 federal income tax return early to obtain a refund. The refund can be hastened by labeling the envelope containing the return "REFUND" and using the appropriate post office box number. Alternatively, electronic filing will also shorten the time between filing and receiving a refund. Use of the direct deposit option is also recommended.

Deductible Expenses

Some graduates will be able to report and deduct expenses which are allowed if they *itemize* their deductions. This occurs when the total itemized deductions exceed the standard deduction amount (*e.g.*, $6,350 for "singles" and $12,700 for "marrieds" are the 2017 figures). Taxpayers such as married graduates who own a home (and are paying mortgage interest and real estate taxes) and/or find themselves in states with high income tax rates (*e.g.*, California, Massachusetts, New York, and Wisconsin) would be the most likely candidates for itemizing. Other expenses that may be included in the itemized deduction category include employee expenses, such as unreimbursed overnight travel and meal expenses, and charitable contributions.

Out-of-pocket costs that can be deducted regardless of the taxpayer's ability to itemize deductions are referred to as "*above-the-line*" deductions. The most likely "above-the-line" components for the 2017 graduate are the deduction for student loan interest and the moving expenses deduction. Also, if you decide to go back to graduate or professional school, up to $4,000 of such costs (*i.e.*, tuition, student activity fees and expenses for course related books, supplies, and equipment that are required as a condition of enrollment or attendance, but not room and board) can be deducted in determining your adjusted gross income (AGI) only if Congress acts to extend this provision (*i.e.*, it expired as of Dec. 31, 2016). These education costs (labelled as a tuition and fees deduction) qualify as "above-the-line" deductions.

Interest on a Student Loan

Interest paid on a student loan is deductible. The interest must be on a "qualified education loan" which includes debt used to cover higher education expenses such as tuition, books, fees, room and board. If the 2017 graduate paid more than $600 in student loan interest during the year, a Form 1098-E, *Student Loan Interest Statement*, will be provided by the payor. This deduction is also "above the line" (*i.e.*, subtracted in computing AGI) with a maximum figure of $2,500 per tax return (even for a married couple who both have loan interest totaling more than $2,500) applying to 2017. There are "phase out" rules that apply to the student loan interest deduction but these are unlikely to play a role in the 2017 graduate's income tax reporting. But if the student is going to be claimed as a dependent on their parent's 2017 tax return (*see* Tax Tip #9 below), this annual deduction would be reported for the first time on the recent grad's 2018 tax return.

Since the 2017 graduate may have other types of interest expense (*e.g.*, advance pay from employer, credit card, personal residence, and vehicle loan), it is important that the source and reason for the interest are documented. Only the interest on a "qualified education loan" is deductible as the 2017 graduate determines his or her AGI.

Example. Mariah, a single 2017 graduate, who will *not* be claimed as a dependent in 2017, is examining the interest she paid during 2017 (*see* Table 1).

TABLE 1.		
Amount	**Organization**	**Type of loan**
$ 450	Beyonce Bank	New vehicle
1,680	Cub College	Tuition and fees
170	Drake Dept. Store	Credit card
50	Eminem Enterprises	Pay advance
1,050	First Place Savings & Loan	Room and board
$3,400		

Since the loans from Cub College and First Place Savings & Loan meet the "qualified education loan" criteria, Mariah may deduct the interest on those loans on her 2017 return. However, the deduction is limited to $2,500 (the 2017 "cap") even though the actual eligible interest payments amount to $2,730 (*i.e.*, $1,680 + 1,050).

TAX TIP #3

Determine and document the source and reason for all interest payments during 2017. Pay particular attention to loans used to pay qualified education expenses since up to $2,500 of interest is deductible when computing AGI.

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Moving Expenses

This special provision allows a taxpayer to deduct the costs involved in moving to his or her "first job" if specific distance-of-move and time-of-employment criteria are met. The distance-of-move test is a 50-mile factor while the time-of-employment requirement is met by working at least 39 weeks in the first 12 months after the move. The deductible expenses include those incurred for the transportation of the taxpayer to his or her new location, the cost of moving personal effects and household goods as well as any cost for lodging while traveling. These expenses are only limited by their "reasonableness." However, the costs of temporary living expenses at the new job location once the move is completed are *not* deductible as well as any house hunting trip expenditures. In fact, should the new employee be reimbursed for such expenses, they must be treated as additional wages.

Example. Juan, a 2017 graduate, moves from Peoria to Milwaukee to start his career. He can deduct the expenses shown in Table 2 on his federal tax return.

TABLE 2.	
Transportation for self	$260
Shipping costs for clothing, books, computer, television set and blue-ray disc player (his only possessions)	500
Ten days accommodation at Mecca Motel (*i.e.,* temporary living expenses in Milwaukee while seeking a rental apartment)	-0-
Total moving deduction	$760

Since employers may report the moving expense reimbursement to the IRS, 2017 graduates should maintain the necessary records to verify the amount spent on moving expenses.

TAX TIP #4

Prepare and maintain a record of the expenses involved in moving to the first place of employment. These include: the actual moving expenses; travel and lodging costs incurred *en route* to the place of employment.

Overnight Travel Expenses

When an individual's employment calls for considerable travel away from their usual business place overnight, taxpayers may be entitled to deduct travel expenses from their AGI as an itemized deduction. The circumstances allowing this treatment to occur when the out-of-pocket expenses exceed reimbursement, if any, from the employer. Since the costs are greater than the reimbursement, the *unreimbursed* costs would be possible deductions since they are included in the compilation of miscellaneous itemized deductions.[3] Specifically, amounts spent for lodging and meals while away from home on business are deductible. However, meal costs may be limited to 50-percent deductibility, if they are *not* reimbursed. Also deductible are such items as baggage charges, reasonable cleaning and laundry expenses, telephone, fax machine expenses, and others. Any substantiated travel expenses that are fully reimbursed by one's employer are treated as neither an income nor a deduction, and therefore, these items would *not* appear on the individual's W-2 and tax return.

Example. Barbara is employed by BoSox Products. Since her job requires out-of-town travel, BoSox Products provides $150 per month as a reimbursement allowance. Barbara is required to substantiate all expenses and must return all advances not spent

on business expenses. From July through December, Barbara incurs $1,500 of expenses while traveling (*i.e.*, lodging costs of $1,000 and $500 for meals) and receives reimbursements of $900 ($600 for lodging and $300 for meals). Barbara's treatment of the situation is shown in Table 3.

TABLE 3.

	Lodging	Meals	Total
Actual spending	$1,000	$500	$1,500
Not reported (a)	$ 600	$300	$ 900
Include in miscellaneous			
itemized deductions	400	100(b)	500(*)
Not deductible	0	100(c)	100
	$1,000	$500	$1,500

(a) As mentioned above, none of these amounts will appear on the W-2 or the tax return.
(b) 50 percent of unreimbursed meal costs (*i.e.,* 50% of $200).
(c) 50 percent of meal costs that are not reimbursed cannot be deducted.
(*) As a component of miscellaneous itemized deductions, the total of $500 will be reduced by 2 percent of Adjusted Gross Income.

Other Business Expenses

As part of one's job, it may be necessary to entertain a customer or client. In some instances, a miscellaneous itemized deduction will be generated to the extent that the expenses exceed any reimbursement. If the reimbursement *equals* the expenditures, neither is reported on the tax return as long as a proper accounting of the expenses was provided to the employer. In other instances, the comparison of actual expenses to the reimbursement can lead to income recognition (where the reimbursement exceeds the expense and the reimbursement is reported on the W-2) or a combination of a miscellaneous itemized deduction and a nondeductible portion (where the reimbursement is less than the expense). Those who qualify as "outside salespeople" (*i.e.*, employees whose W-2 forms are marked with an "X" for "statutory employee") may be permitted special treatment since they are allowed to report all outside income and the related expenses on Schedule C. As a result of this provision, the "outside salesperson" may avoid the two percent of AGI hurdle that pertains to miscellaneous itemized deductions. Entertainment expenses include disbursements incurred at restaurants, cocktail lounges, country clubs, other similar establishments, and sporting events. However, any club dues (including airline, country club, and golf/athletic facility dues) are *not deductible*. Finally, any *unreimbursed entertainment expense deductions* are limited to 50 percent of their total *and* must exceed two percent of AGI when totaled with other miscellaneous deductions to be included in total itemized deductions.

Example. Three 2017 graduates (Aaron, Adele, and Amy) receive an entertainment allowance of $200/month (*i.e.*, a total of $1,200 for 2017). The allowances are *not* reported on the Form W-2 by the employers since all expenses incurred must be substantiated and any excess advances *must* be returned. Aaron spends $1,000, Adele's expenditures are $1,200, while Amy tallies $1,600 of entertainment expenses. Proper treatment for each of the above if none of the taxpayers were an "outside salesperson":

- Aaron—Reports $200 (*i.e.*, $1,200 – 1,000) of other income based on Form 2106 instructions and the return of the $200 to his employer did not occur until 2018.[4]
- Adele—Since the allowance equals the expenses, there is no need to report either the allowance or the expenditures assuming that a proper accounting to the employer occurs.[5]
- Amy—A deduction of $200 is permitted (*i.e.*, 50 percent of the unreimbursed $400). The $200 is included as a miscellaneous itemized deduction. Thus, it may *not* be deductible if (1) Amy is not able to itemize or (2) Amy's total miscellaneous itemized deductions do not exceed two percent of her AGI.

TAX TIP #5

Familiarize yourself with the types of deductible expenses incurred as part of your employment. Prepare and maintain a record of these expenses which can include travel, meals, lodging, entertainment, and educational costs. Also, if possible, insist on specific item reimbursement instead of a general allowance system.

Itemized Deductions

Most graduates will not be itemizing deductions during their first years as wage-earners due to the substantial standard deduction which is available. To derive any tax benefit from itemizing deductions, the total of these deductions *must exceed* the standard deduction amounts in Table 4.

TABLE 4.

Filing Status	Basic Standard Deduction for 2017
Single	$6,350
Head of Household	$9,350
Married Filing Jointly	$12,700

The possibility of itemizing deductions increases when a taxpayer resides in a high-income tax state (*e.g.*, California, Massachusetts, New York, and Wisconsin), has had sizeable uninsured or unreimbursed medical expenses and/or when he or she owns a home and incurs interest on a mortgage, and pays real estate taxes. Medical expenses (in excess of percentage limitations), personal property taxes, and real estate property taxes are usually included in the list of itemized deductions along with state income taxes or state sales tax, charitable contributions, and casualty losses. Teaching supplies, journal subscriptions, and further educational costs are usually included in the miscellaneous itemized deduction category. An expanded discussion of educational expenses is included in a later section.

Example. Carrie, a single taxpayer, receives her MBA in May of 2017. Table 5 lists her potential itemized deductions for 2017. Carrie will itemize deductions on her return since the total is greater than the $6,350 standard deduction amount. If the total was less than the standard deduction, Carrie would not itemize.

TABLE 5.

Interest paid on a car loan (amounts to $400)	$ 0[1]
Interest paid on a home mortgage loan	3,500
State and local income taxes	1,280
Real estate taxes	1,500
Charitable contributions	600[2]
Personal property taxes (included as a portion of automobile license plate cost)	360
TOTAL ITEMIZED DEDUCTIONS	$7,140

ENDNOTES

1 No deduction is allowed for personal interest unless it is in connection with a home equity loan.

2 Charitable contributions equal to or greater than $250 must be supported by documentation provided by the organization (*e.g.*, church, community group, university) that received the cash or property contribution. Simply having a cancelled check for the donation is not sufficient for tax purposes. The charity should be aware of this rule and should supply a documented receipt.

TAX TIP #6

Do not attempt to itemize deductions unless you have incurred substantial unreimbursed medical costs, state and local income taxes, home mortgage interest, real estate, and/or personal property taxes during 2017 and expect this total to surpass the 2017 standard deduction amount for your filing status.

Tax Credits

There are several tax credits that the 2017 graduate will be eligible for including the child and dependent care credit, the child tax credit, the Lifetime Learning Credit, and the American Opportunity Tax Credit. However, unless the 2017 graduate has a child or is paying for the care of a child or other dependent (*e.g.*, aging parent), the American Opportunity Credit (AOC) or the Lifetime Learning Credit (LLC) are the most likely candidates for inclusion on the 2017 return. One of these credits (but not both) may be reported by either the student *(if not claimed as a dependent)* or his/her parent(s).

The Lifetime Learning Credit is determined by multiplying 20 percent of the first $10,000, spent in 2017, to take one or more courses (including graduate level offerings) at an "eligible educational institution." Thus, the 2017 diploma winner could reduce his or her taxes by up to $2,000 as long as he or she paid as much as $10,000 of tuition and fees during 2017. If one's parent(s) paid the education bills, the American Opportunity Credit will be reported on the tax return of the parent(s) subject to a phase-out rule that is triggered when modified AGI is above $80,000 for a single or head of household taxpayer or $160,000 when the return indicates a married filing jointly status. The American Opportunity Credit can reach $2,500 and as much as 40 percent of the credit can be refundable if the taxpayer's tax liability does not cover the full amount of the American Opportunity Credit.

Example. Chandra graduated in May 2017 with a bachelor's degree. Her parents paid $5,400 in tuition and fees for Chandra's final semester at an eligible educational institution. After starting her job, Chandra decided to take an evening course at an eligible educational institution paying $1,200 of tuition and fees. She enjoyed the course and decided to enroll in the follow-up course. The $1,400 tuition for the second course (which starts in late January of 2018) is paid in 2017.[6]

Based on the above and assuming Chandra is claimed as a dependent on her parents' tax return and that the parents have not claimed the AOTC for more than three prior tax years, the following maximum credit could be listed for 2017:

- $2,500 on the 2017 tax return of Chandra's parents as an American Opportunity Credit assuming that their AGI was at or below $160,000.

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If Chandra *cannot be claimed as a dependent*, she could claim the LLC on her 2017 tax return as follows:

- $520 on Chandra's 2017 tax return (*i.e.*, 20 percent of $2,600 spent in 2017) assuming that her AGI was $54,000 or below. Alternatively, a $2,600 tuition and fees deduction could be claimed (if Congress acts to extend this provision as discussed above) in determining her AGI. The decision as to which would generate the largest tax savings (*i.e.*, a tax credit or a deduction) would depend on Chandra's tax bracket in 2017.

TAX TIP #7

Claim the American Opportunity Tax Credit or Lifetime Learning Credit for 2017 tuition and fee payments (including prepayments) made to any "eligible educational institution." Alert your parent(s) to the eligibility requirements that may allow the reporting of the American Opportunity Credit on their 2017 tax return.

Tax Planning Considerations

Many taxpayers feel that tax planning can only be carried out by taxpayers whose income is in the six-figure category. However, the 2017 graduate can also do some planning which will minimize his/her tax burden as well as that of the graduate's parent(s). Two specific areas include the timing of income and the protection of the dependency exemption on the parental 2017 return.

Timing of Income

It is generally wise tax-planning to move as much income into 2017 (*i.e.*, the year of graduation) as possible since the highest marginal tax rate (*i.e.*, the highest tax bracket applied against your last dollars of income) will probably be lower in 2017 (when you will be earning an income for *less than a full year*) than in the next year (when you will most likely be employed during the *entire year*). Since the potential marginal rate in 2018 of 25 percent, 28 percent, or 33 percent is significantly higher than the likely 2017 rate of 15 percent, this type of planning should not be taken lightly. The types of income that can be shifted include interest on U.S. Savings Bonds, capital gains, proceeds from a redeemed insurance policy, and overtime pay that certain organizations (*e.g.*, CPA firms) allow employees to "bank." For example, accelerating $500 into 2017 (as opposed to delaying its receipt until 2018) could create a tax savings of $50 or more. Granted such activity would trim the refund discussed above in Tax Tip #2 but such income movement might make a lot of tax sense.

TAX TIP #8

Examine situations that would enable you to recognize income in 2017, instead of 2018. Where possible, shift that income into 2017.

Dependency Exemption for Graduate's Parent(s)

For over 20 years, the tax returns filed by the parent(s) of the 2017 graduate included his or her name and a dependency exemption which reduced the parental tax liability. The graduation year return can continue to carry this tax benefit if the graduate is less than 24 years old at the end of 2017 and careful records are maintained. There are several criteria which must be met in order to qualify as a dependent on the parental return. In the year of graduation, four must be watched closely. First, the graduate cannot file a married filing joint return for any reason other than to garner a full refund. Second, the 2017 degree recipient must live with his/her parents for greater than six months. (Note: time lived away from home while a full-time student counts as "living with parents.") Third, the *2017 graduate must be able to prove that his or her resources provided less than* 50 *percent of his or her support* (*i.e.*, parental funds and support from others *including loans and scholarships* must have been used for over half of the clothing, health care, education, food, and shelter costs). Proof of this type of spending will be based on records kept by the graduate and his or her parent(s) and other providers of support. Also, the graduate must have been a "full-time" student during at least all or part of *five months* of the tax year.[7]

Assuming that the graduate starts living away from his or her parent's home and paying for upkeep in September, his or her 2017 expenditures can determine whether or not Mom and Dad will be able to claim the recent alum as a dependency exemption. For example, if the parents are paying all educational and other expenses until September 1, it would not be unreasonable to assume a spending level of $8,000 for that eight-month period. If the graduate spends less than $8,000 on support during the final four months of the year of graduation, the parents can claim him or her as a dependency exemption on their return. The resulting tax savings would be based on the highest marginal tax bracket applicable to the parents.

The good news (for the parents) is that they will cut their tax bill based on their marginal tax bracket multiplied by the dependency deduction (*i.e.*, $4,050 for 2017). The bad news is that the graduate cannot claim the same dependency deduction on his or her return.[8] Referring to an earlier example, parental use of the exemption would impact the Form W-4 choice (*i.e.*, graduating individual should claim 2 exemptions instead of four), take-home pay and the expected refund (*see* Table 8). Nonetheless, the overall result is a tax savings (assuming a 25-percent marginal rate for the parents and a 15-percent rate for the graduate while using a $4,050 figure) as shown in Equation 1.

EQUATION 1.

Parent savings 25% x $4,050	=	$1,012.50
Graduate's cost 15% x $4,050	=	*(607.50)*
Net result – Save		$ 405

TAX TIP #9

Protect the dependency exemption of your parent(s) by (a) documenting your support spending *before* and *after* you are employed and (b) spending less on your support from your funds than the amount spent by your parent(s) and others who provided resources for your support.

Other Considerations

Several other situations could be discussed, including the possible marriage penalty which is addressed in Appendix A. Let us take a closer look at three areas—education expenses, nondeductible expenses, and Individual Retirement Accounts (IRAs).

Education Expenses

Since a taxpayer cannot claim more than one type of tax benefit for the same expenditure, the taxpayer will want to explore which route (*i.e.*, deductible expense or Lifetime Learning Credit) would be the most beneficial for 2017 education expenses incurred after graduating. Tuition and fees up to $10,000 will qualify for the 20-percent Lifetime Learning Credit mentioned earlier. None of these costs would qualify for the *American Opportunity Tax Credit* since this *is only available for the first four years of post-secondary education*.

As a general rule, the pursuit of an advanced degree or law degree will *not* be allowed as a deductible education expense. However, if the advanced degree is a requirement to maintain one's present position, the costs are included in miscellaneous itemized deductions (*e.g.*, teacher seeking a master's degree based on a state requirement for retention of position). Other qualifying education expenses maintain or improve skills required in one's present trade or business (*e.g.*, salesperson enrolling in a course involving a better technical understanding of the product or service he/she sells; engineer studying various types of materials and their ability to withstand stress). Nevertheless, if a $4,000 for-AGI deduction is permitted for tuition and fees (as discussed earlier), this distinction is not critical (at least for the first $4,000 of such out-of-pocket spending). Now, only if the unreimbursed costs exceeded $4,000, would the taxpayer have to meet the tests mentioned above in order to take a miscellaneous deduction for the amount in excess of $4,000.

Disbursements included in the *eligible education expenses* category are those for tuition, books, fees, and supplies.[9] In addition, transportation costs including the use of a personal vehicle to go to and from the place where the class and/or seminar is conducted are also allowed. (Note: in 2017 a rate of 53 cents/mile is permitted). Finally, 50 percent of the unreimbursed cost of meals is an eligible education expense. Since these costs are categorized as miscellaneous itemized deductions, there is a chance these expenses will not be included in the overall itemized deductions total. This occurs because these costs must exceed, when combined with all other miscellaneous itemized deductions, a two percent of AGI hurdle to be included in the final tally of overall itemized deductions. More importantly, the new grad must be able to itemize his/her deductions (versus taking the standard deduction) and the excess portion of such expenses (*i.e.*, above the $4,000) was not incurred in order to qualify for a new trade or business.

Example. Three recent graduates (*who are not reported as a dependent by their parents)* are enrolled in an MBA program and are each taking two courses during the current semester while working full-time. They are not receiving any reimbursement from their respective employers. CHET, a recent graduate (whose marginal tax bracket is 15 percent) is in the program to improve his skills for his present management position. URSULA, a taxpayer in the 25-percent marginal tax bracket, is maintaining her skills by taking the course. BRAD (also in the 25-percent marginal tax bracket) is enrolled in the program because it is a prerequisite for an administrative position that he will seek. Without the MBA, he would not be eligible for the job. Assuming that all three can itemize deductions and that their miscellaneous

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itemized deductions will exceed two percent of their AGI, Table 6 pertains to the current year.

TABLE 6.

The following pertains to the current year:

	CHET	URSULA	BRAD
Tuition	$5,400	$5,400	$5,400
Books	400	400	400
Required Supplies fee	200	200	200
Total Costs:	$6,000	$6,000	$6,000
Tuition and Fees Deduction	$4,000	$4,000	$4,000
Miscellaneous Itemized Deduction	$2,000	$2,000	$ -0-
	or	or	or
Lifetime Learning Credit	$1,200	$1,200	$1,200

- *CHET* would choose to report the Lifetime Learning Credit since that would reduce his overall tax liability by $1,200. The tax savings generated by listing the Tuition and Fees Deduction plus the Miscellaneous Itemized Deduction amounts to $900 (*i.e.*, 15% of $6,000).
- *URSALA's* choice would involve reporting the Tuition and Fees Deduction (given that Congress acts to extend this provision) along with the Miscellaneous Itemized Deductions thereby generating an overall drop in tax liability of $1,500 (*i.e.*, 25% of $6,000) as opposed to taking a $1,200 Lifetime Learning Credit.
- *BRAD* enrolled in the MBA program to enable him to qualify for a new position (*i.e.*, a new trade or business). Thus, none of the costs listed above would be deductible as a miscellaneous itemized deduction but the $4,000 Tuition and Fees Deduction would reduce his taxes by $1,000. And, he would qualify for and report a Lifetime Learning credit of $1,200 (*i.e.*, 20% of $6,000).

TAX TIP #10

When you are not reported as a dependent by your parent(s), document the relationship of educational expenses to (a) requirement established by state or employer or (b) maintenance and/or improvement of skills required in your current trade or business. Given that up to $4,000 Tuition and Fees Deduction can be claimed, determine whether your tax liability is reduced more by treating the remaining eligible educational expenses as a miscellaneous itemized deduction or by using all of the educational expenses in computing the Lifetime Learning Credit.

Nondeductible Expenses

Keeping correct and complete records can save a taxpayer a lot of time, trouble and "treasure" at tax time. Therefore, it is important to be aware of information that is not critical for tax return purposes since such activity does not generate any tax benefit. In keeping tax records, the following items are not deductible: nonprescription medicines, life insurance premiums, cost of a personal wardrobe, spending on personal entertainment, health club fees, and spending on a personal vehicle (unless the vehicle is used for both personal and business purposes).

TAX TIP #11

Do not waste precious time and space maintaining information about spending that has no tax consequences. Furthermore, tax returns and the supporting data should be kept for at least *three* years.

Individual Retirement Accounts

Discussing retirement with a 2017 graduate seems to be a ludicrous exercise until you examine the potential benefits. Illustration A in Table 9 demonstrates how per year contributions[10] to an IRA for 46 years—an overall investment of $252,000—grow to over $600,000. For the individual deciding to wait before starting to fund an IRA or similar arrangement, Illustration B in Table 9 shows an extended delay followed by yearly contributions amounting to $252,000 will build a retirement fund that is over $250,000 *less* than Illustration A results when the taxpayers reach age of 70. In many instances, contributions to an IRA will be tax-deductible if the employee is not eligible to be covered by an employer-provided retirement plan. Here, we ignore the tax savings that may occur since the results are so compelling.[11]

TAX TIP #12

Establish an IRA or similar retirement arrangement—such as a 401(k) Plan—as soon as possible. Contribute the maximum amount to the IRA and allow it to grow until retirement.

Conclusion

Our tax laws are complex and constantly changing. This article highlighted several aspects of the federal income tax law particularly applicable to the 2017 graduate and developed a list of 12 Tax Tips (*see* Table 10). Hopefully, the effort will improve income tax literacy for 2017 diploma winners.

TABLE 7.

	Number of Form W-4 Allowances	
	1	4
Salary	$4,000	$4,000
Less:		
(a) Federal withholding tax	(518)	(333)
(b) FICA (Social Security/ Medicare)	(306)	(306)
(c) State income tax	(160)	(160)
"Take-home" pay	$3,016	$3,201

(a) Based on the 2017 withholding tables for Single Persons-Monthly Payroll Period Per Publication 15 (Circular E), Employer's Tax Guide.
(b) Rate is 7.65 percent (6.2-percent Social Security; 1.45-percent Medicare).
(c) Rate of four percent is used here.
NOTE: All numbers are rounded.

TABLE 8.

Number of Form W-4 Allowances taken is 2	
Salary	$4,000
Less:	
(a) Federal withholding tax	(434)
FICA (Social Security/Medicare) - 7.65%	(306)
State income tax - 4%	(160)
"Take-home" pay	$3,100

(a) Based on the 2017 withholding tables for Single Persons-Monthly Payroll Period. Per Publication 15 (Circular E), Employer's Tax Guide.

Anticipated Refund	
Federal tax withheld 6 × $434 =	$2,604
Tax on a taxable incomeof $17,650 (*i.e.*, $24,000 minus $6,350) using a marginal rate of 10% on the first $9,325 and 15% on the remaining $8,325.*	(2,181.25)
Refund	$ 422.75

* Parents are claiming an exemption for the graduate who is less than 24 years old by the end of 2017. Thus, the graduate's taxable income is not reduced by a personal exemption.

TABLE 9.

Assumptions—Yearly contribution; 4% simple interest compounded annually before yearly contribution.

		Illustration A		Illustration B	
Year	Age	Contribution	Cumulative Amount(*)	Contribution	Cumulative Amount(**)
2020	25	$ 1,000	$ 1,000	$ -0-	$ -0-
2021	26	$ 2,000	$ 3,040	$ -0-	$ -0-
2022	27	$ 3,000	$ 6,162	$ -0-	$ -0-
2023	28	$ 4,000	$ 10,408	$ -0-	$ -0-
2024	29	$ 5,000	$ 15,824	$ -0-	$ -0-
2025	30	$ 5,000	$ 21,457	$ -0-	$ -0-
2026	31	$ 5,000	$ 27,315	$ -0-	$ -0-
2027	32	$ 5,000	$ 33,408	$ -0-	$ -0-
2028	33	$ 5,000	$ 39,744	$ -0-	$ -0-
2029	34	$ 5,000	$ 46,334	$ -0-	$ -0-
2030	35	$ 5,000	$ 53,187	$ -0-	$ -0-
2031	36	$ 5,000	$ 60,314	$ -0-	$ -0-
2032	37	$ 5,000	$ 67,727	$ -0-	$ -0-
2033	38	$ 5,000	$ 75,436	$ -0-	$ -0-
2034	39	$ 6,000	$ 84,453	$ -0-	$ -0-
2035	40	$ 6,000	$ 93,831	$ -0-	$ -0-
2036	41	$ 6,000	$103,584	$ -0-	$ -0-
2037	42	$ 6,000	$113,727	$ -0-	$ -0-
2038	43	$ 6,000	$124,276	$ -0-	$ -0-
2039	44	$ 6,000	$135,247	$ -0-	$ -0-
2040	45	$ 6,000	$146,657	$ -0-	$ -0-
2041	46	$ 6,000	$158,523	$ -0-	$ -0-
2042	47	$ 6,000	$170,864	$ -0-	$ -0-
2043	48	$ 6,000	$183,699	$ -0-	$ -0-
2044	49	$ 6,000	$197,047	$ -0-	$ -0-
2045	50	$ 6,000	$210,929	$ 12,000	$ 12,000
2046	51	$ 6,000	$225,366	$ 12,000	$ 24,480
2047	52	$ 6,000	$240,381	$ 12,000	$ 37,459
2048	53	$ 6,000	$255,996	$ 12,000	$ 50,957
2049	54	$ 6,000	$272,236	$ 12,000	$ 64,995
2050	55	$ 6,000	$289,125	$ 12,000	$ 79,595
2051	56	$ 6,000	$306,690	$ 12,000	$ 94,779
2052	57	$ 6,000	$324,958	$ 12,000	$110,570
2053	58	$ 6,000	$343,956	$ 12,000	$126,993
2054	59	$ 6,000	$363,714	$ 12,000	$144,073
2055	60	$ 6,000	$384,263	$ 12,000	$161,836
2056	61	$ 6,000	$405,634	$ 12,000	$180,309
2057	62	$ 6,000	$427,859	$ 12,000	$199,521
2058	63	$ 6,000	$450,973	$ 12,000	$219,502
2059	64	$ 6,000	$475,012	$ 12,000	$240,282
2060	65	$ 6,000	$500,012	$ 12,000	$261,893
2061	66	$ 6,000	$526,012	$ 12,000	$284,369
2062	67	$ 6,000	$553,052	$ 12,000	$307,744
2063	68	$ 6,000	$581,174	$ 12,000	$332,054
2064	69	$ 6,000	$610,421	$ 12,000	$357,336
2065	70	$ 6,000	$640,838	$ 12,000	$383,629
	Total Investment	$252,000		$252,000	

(*) Numbers are rounded. Illustration A reflects increasing payments starting in 2020 while payments begin in 2045 in Illustration B. Illustration A builds to a maximum contribution of $6,000 per year while Illustration B works with a maximum contribution of $12,000 per year. None of the payments reflect an adjustment for inflation.
(**) Assumes that the 2017 graduate has married and he or she and his/her spouse contribute to an IRA account.

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TABLE 10. TAX TIP

#1 Avoid over-withholding in 2017 by increasing the "number of allowances" on Form W-4. Remember to change to the proper "number of allowances" at the beginning of 2018.

#2 Be prepared to file the 2017 Federal income tax return early to obtain a refund. The refund can be hastened further by labeling the envelope containing the return "REFUND" and using the appropriate post office box number. Alternatively, electronic filing will also shorten the time between filing and receiving a refund. Use of the direct deposit option is also recommended.

#3 Determine and document the source and reason for all interest payments during 2017. Pay particular attention to loans used to pay qualified education expenses since up to $2,500 is deductible when computing Adjusted Gross Income.

#4 Prepare and maintain a record of the expenses involved in moving to the first place of employment. These include: the actual moving expenses; travel and lodging costs incurred en route to the place of employment.

#5 Familiarize yourself with the types of deductible expense incurred as part of your employment. Prepare and maintain a record of these expenses which can include travel, meals, lodging, entertainment and educational costs. Also, if possible, insist on specific item reimbursement instead of a general allowance system.

#6 Don't attempt to itemize deductions unless you've incurred substantial unreimbursed medical costs, state and local income taxes, home mortgage interest, real estate and/or personal property taxes during 2017 and expect this total to surpass the 2017 standard deduction amount.

#7 Claim the American Opportunity Tax Credit or Lifetime Learning Credit for 2017 tuition and fee payments (including prepayments) made to any "eligible educational institution." Alert your parent(s) to the eligibility requirements that may allow the reporting of the American Opportunity Credit on their 2017 tax return.

#8 Examine situations that would enable you to recognize income in 2017 instead of 2018. Where possible, shift that income into 2017.

#9 Protect the dependency exemption of your parent(s) by (a) documenting your support spending *before* and *after* you are employed and (b) spending less on your support from your funds than the amount spent by your parent(s).

#10 When you are not reported as a dependent by your parent(s), document the relationship of educational expenses to (a) requirement established by state or employer or (b) maintenance and/or improvement of skills required in your current trade or business. Following an up to $4,000 Tuition and Fees Deduction (given Congress acts to extend this provision), determine whether your tax liability is reduced more by treating the remaining eligible educational expenses as a miscellaneous itemized deduction or by using all of the educational expenses in computing the Lifetime Learning Credit.

#11 Do not waste precious time and space maintaining information about spending that has no tax consequences. Furthermore, tax returns and the supporting data should be kept for at least *three* years.

#12 Establish an IRA (Individual Retirement Account) or similar retirement arrangement—such as a 401(k) plan—as soon as possible. Contribute the maximum amount to the IRA and allow it to grow until retirement.

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ENDNOTES

[1] An alternative, the Part-Year Method, is also available. However, coverage of this approach is beyond the scope of this article. Details are available in Publication 505 Tax Withholding and Estimated Tax.

[2] Based on a taxable income figure of $13,600 ($24,000 reduced by 2017's standard deduction of $6,350 and one personal exemption of $4,050). Tax on $13,600 is $1,565 (rounded) as computed in Equation 2.

EQUATION 2.

10% rate x $9,325	=	$932.50
15% x $4,275	=	641.25
		$1,573.75

[3] Miscellaneous deductions are included in total itemized deductions if they exceed two percent of a taxpayer's AGI.

[4] Form 2106, *Employee Business Expenses*, is used to report entertainment expenses and to compare these expenses with reimbursements.

[5] Alternatively, if the allowance is included in Adele's gross income, she will be allowed a $1,200 deduction using Form 2106.

[6] Payments in the current year for courses commencing within the first three months of the following year are eligible for the current year Lifetime Learning Credit. The American Opportunity Credit is only allowed for the first four years of college.

[7] Full-time student status is based on the particular institution's criteria.

[8] The $2,500 student loan interest deduction would also be lost due to the 2017 status as a dependent. If the 2017 graduate is in the 15-percent bracket, a maximum tax savings of $375 (*i.e.*, 15% × $2,500) would be given up by the diploma winner but his/her parent(s) would generate a possible tax savings—assuming a 25-percent marginal tax rate equal to $625 (*i.e.*, 25% × $2,500).

[9] Not included as deductible education expenses are seminars unrelated to one's job or employment (*e.g.*, physical fitness course and journalizing workshop).

[10] Legislation increased the yearly maximum contribution to $5,000 for 2008. After 2008, the $5,000 is adjusted for inflation. In 2017, the IRA contribution limit is $5,500. Individuals who are 50 or older have been allowed an additional $1,000/year since 2006.

[11] Any IRA contributions made which are not tax-deductible may require some detailed record keeping. In fact, if potential tax savings is not a major factor, especially for a 2017 graduate, consideration should be given to making the contribution to a Roth IRA where there is *no tax deduction* upfront while *none of the money will be taxed upon retirement* (as would be the case of money withdrawn from a regular IRA).

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