

Tax Reform and Travelers

1/5/2018

Congress passed the most sweeping tax changes in 30 years before Christmas in 2017 and it will affect almost every taxpayer. The majority of the new rules take effect 1/1/18 and do not apply to the 2017 return that we file in 2018. The 2018 return that we file for in 2019 reflects almost all of the changes.

What about Travelers and their Agencies? How are they affected? Below are the highlights and then a lengthy discussion on how these changes affect your return and strategies

Highlights

- 1) STIPENDS/PER DIEMS/ TRAVEL REIMBURSEMENTS ARE NOT BEING TAXED
- 2) The tax home requirement DOES NOT CHANGE
- 3) As of 1/1/18 an employee can no longer deduct unreimbursed employee business expenses like mileage, meals, CEUS, uniforms, licenses, union dues etc.
- 4) New "pass through" rates mean that independent contractors are only taxed on 80% of their net income
- 5) Withholding for most will drop this February after the IRS releases new withholding tables
- 6) New Corporate tax rate at 21%
- 7) IRS Likely to change reporting (not taxation) of stipends in the future
- 8) With new lower corporate tax rate, it is uncertain if traveler wages will rise as facilities/hospitals may try to lower bill rates
- 9) Recordkeeping is still necessary to justify the tax free per diems.

Detailed Analysis

TAX HOME RULES ARE THE SAME

A qualifying tax home is still required to receive any travel related per diems, stipends, subsidies, allowances etc. (these are all forms of REIMBURSEMENTS) on a tax-free basis. At the same time, a significant enforcement/compliance tool that the IRS has been using was removed which will most likely lead to a change in the reporting requirements and audit selection. We will address later in the article. For a detailed Q&A on Tax Homes, please visit <http://traveltax.com/traveler.html>

STIPENDS ARE UNTOUCHED

Facebook, social media sites, breakrooms and the Pyxis station were lit up with rumors that the new tax laws were going to end tax free stipends. Those rumors are simply that – rumors. This was never contemplated.

EMPLOYEE BUSINESS EXPENSES ARE GONE

This is by far the most important change for travelers. Starting with 2018, travelers can no longer deduct the costs of transportation, meals, lodging, seminars, licenses, uniforms, shipping, rental cars in excess

of reimbursements. This change also extends to investment fees, ROTH losses, repayment of bonuses less than \$3K. It changes the way many travelers will approach their contracts. For example, the 2K drive to the new assignment which may generate deductions of over \$1000 is not deductible even if the agency only gives you \$300.

But doesn't the standard deduction increase make up for that?

The standard deduction doubles to \$12,000 for a single individual and \$24,000 for joint filers. At first glance this seems to be a great benefit until you look at the fine print. In the past a single individual would have a standard deduction of \$6300 plus a personal exemption of \$4050 (based on 2016 tax returns). This personal exemption part has been completely removed. So while the standard deduction almost doubles to \$12,000, the initial benefit gained is only \$1650. Most travelers easily have more than this in additional travel deductions.

There is an additional "catch to this restructuring. Previously, an individual only had to exceed the \$6300 threshold to benefit from itemizing and they then could add the personal exemption. Now, to itemize, an individual must have more than \$12,000 of itemized deductions to benefit and they no longer have the bonus of the exemption.

For some travelers this is actually a very good deal. The average single traveler who does not own the home, gives nothing to charity, travels within 500 miles of home who does not itemize will see an immediate benefit of a higher standard deduction even without the personal exemption.

However, there is a considerable number of travelers who stand to lose. To illustrate, let's assume that the traveler has \$2500 of state and local income taxes, gives \$1000 to charity, and has a large amount of mileage and meal deductions that are not fully reimbursed to the tune of \$7000

WITHOUT ITEMIZED DEDUCTIONS	OLD 2016	NEW LAW
Standard Deduction	6300	12000
Personal Exemption	4050	0
Total	10350	12000
Gain of \$1650 in deductions or roughly \$363 decrease in tax based on new brackets		
WITH ITEMIZED DEDUCTIONS	OLD 2016	NEW LAW
State income taxes	2500	2500
Charity	1000	1000
Employee business expenses	7000	0
Sub Total	10500	[3500] instead use 12000 standard deduction
Personal Exemption	4050	0
Total	15000	12000
Loss of \$3000 in deductions or roughly \$660 in additional taxes based on new brackets		

The impact is more significant for travelers who work seasonal assignments at hospitals that maintain their own travel pools. Generally, these facilities provide some travel pay, housing but no meal allowances. However, these transportation and housing amounts are added to taxable income as these facilities rarely provide tax-free reimbursements. Many travelers working these kinds of contracts have allowable deductions approaching \$8000 just for the three months of work. With employee business expenses gone, there is no tax relief for these expenses.

Another type of contract that will have a diminished value is one where the agency provides the actual housing, pays a small amount for travel and no meal allowance. Travelers working these types of contracts will have roughly \$5000 of allowable deductions for transportation and meals per each 3-month period. Again, since employee business expenses are no longer deductible, these types of travelers will have to foot those expenses without any tax relief.

The travelers who stand to lose the most are the ones who own their own homes, have mortgage interest and real estate taxes that they normally would claim on their tax return in addition to any business expenses they have. When one does the math, this increase in the standard deduction severely diminishes the tax benefit of homeownership and charity since the threshold of deducting these items is significantly increased.

To illustrate, let's assume that an individual has \$6000 a year of mortgage interest and \$2000 a year of real estate taxes, \$2500 worth of state income taxes and \$5000 of travel expenses.

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Standard Deduction	6300	12000
Personal Exemption	4050	0
Total	10350	12000
Gain of \$1650 in deductions or roughly \$363 decrease in tax based on new brackets.		
WITH ITEMIZED DEDUCTIONS	OLD 2016	NEW LAW
Mortgage interest	6000	6000
Real estate taxes	2000	2000
State income taxes	2000	2000
Employee business expenses	5000	0
Sub Total	15000	[10000] instead use 12000 standard deduction
Personal Exemption	4050	0
Total	19050	12000
Loss of \$7050 in deductions or roughly \$1551 in additional taxes based on new brackets		

HOW WILL STAFFING AGENCIES RESPOND TO THIS??

Later we will look at the new corporate tax rates in more detail but one of the most significant changes with tax reform is the lower Federal corporate tax rate of 21%. Prior to tax reform, United States corporate tax rates were the second highest in the world when you include state tax rates. Only the UAE had a higher one. Our corporate tax rate under the old law was 40% (factoring in the state tax) which significantly hindered our ability to compete on the global scale. A prime example of this is the fact that Medtronic purposely restructured their operations to become an Irish based company. Irish corporate rates are 12.5%. Even more bizarre, is the fact that Burger King is a Canadian company after restructuring their operations to take advantage of the lower corporate rates in all places, Canada. The new lower rates have changed this for the better, but it brings up a big question for travelers: will wages for travelers increase now that the agencies have a lower tax rate?

There is no one answer to this. Most of the customers the agencies cater to are nonprofits. Only about 18% of hospitals are for-profit. The non-profit hospitals don't necessarily benefit from the lower corporate tax rate. But at the same time, they are fully aware that they have a new tool in their negotiations now that the agencies stand to reap a higher profit from a contract with a facility. Will hospitals now lower their bill rates knowing that the agency profit and bottom-line will not suffer comparably with lower corporate rates? That remains to be seen.

One thing is sure to happen in the coming year. Many agencies concentrate their reimbursements in housing and meals. Most of the time, the travel pay is capped between \$300 and \$500 regardless of distance. As mentioned before, that 2000-mile drive to a facility for an assignment is no longer deductible. Given that it was in the past how is a traveler going to feel knowing that they no longer can deduct these expenses? This is where reimbursements might start to look different. In addition to transportation, lodging and meals, travelers incur significant expenses for licenses, continuing education, specific uniforms required by the assignment facility and other miscellaneous expenses such as equipment, reference guides and not to mention the large amount of expenses that occur when a facility decides to dump travelers or cancel - none of these expenses are deductible under the new rules.

We may find agencies reworking their reimbursement practices to accommodate a broader range of expenses. For example, instead of concentrating a large amount of reimbursements in housing, some of the housing allowance can be shifted to items like licenses and continuing education. If a traveler is reimbursed for their housing, meals, mileage and licenses, and continuing education, they are less likely to think that traveling does not have a financial benefit. However, this is where a traveler needs to be cautious – it is a perceived value versus an absolute value. To illustrate, let's say an agency gives \$2000 a month for housing, \$1000 a month for meals and \$300 one way for travel (\$600 round-trip). The total amount of reimbursements for three-month contract is then \$6000 + \$3000 + \$600 = \$9600. Instead of concentrating so much reimbursement in the housing and meals, let's say the agency decided to give \$1500 a month for housing, \$750 a month for meals, \$750 each way for travel (\$1500) and \$1350 for licenses, continuing education, and mandatory uniforms. The total amount of these reimbursements is still \$9600 for the three-month contract; however, the perception is that most of the expenses for the contract are covered. The perception has improved, but the absolute value of the reimbursements has not.

INDEPENDENT CONTRACTING

The reduction in corporate tax rates included not only corporations, but any person engaging in business activity other than that of an employee. This includes self-employed individuals (1099), individuals in a partnership, those with LLCs and S Corps.

Outside of physicians, nurse practitioners and other advanced practice professionals, most healthcare travelers have not been able to work as independent contractors. To start, many are not interested in working as independent contractors due to the additional amount of paperwork that is involved. Moreover, the IRS and the Department of Labor generally view the work of the bedside nurse, therapist etc. as supervised employee activity versus an independent contractor. This worker classification hurdle has generally prevented most travelers from working independently.

Under the new tax laws, self-employed individuals and anyone who receives what is dubbed “pass-through income” will only be taxed on 80% of their net business income (profit after expenses) starting with 2018 so long as their total income does not exceed \$315,000 for joint filers and \$157,500 for individual filers. For example, if someone is self-employed and earns a net income of the \$100,000 they will only be taxed on \$80,000. They will still pay self-employment taxes (Social Security and Medicare) on the \$100,000 of net but the deduction of \$20,000 of taxable income will reap a \$4800 tax break compared with the previous laws.

In addition, all the expenses that are lost as an employee are still deductible as an independent contractor. These changes may usher a movement in healthcare staffing towards an independent contracting/self-employment model. Currently, there are very few agencies that have passed the tests of the Internal Revenue Service and Department of Labor that would allow them to treat a healthcare professional as an independent contractor. This does not however preclude an individual from attempting to contract directly with a facility and form their own LLC as a mini staffing agency or even subcontract with an established agency. The world’s workforce is moving toward what is called the “Gig Economy” which is fertile ground for contracting status.

IRS REPORTING

Since employee business expenses are no longer allowed, the IRS has lost an important window into the reimbursement practices of employers. Under the old laws, when an individual had a high amount of employee business expenses on their tax return, the IRS could audit that taxpayer and request a copy of the employment agreement with the staffing agency. In the last six years there have been many audits of healthcare staffing agencies, many of which were triggered from the review of the employment agreements during a traveler audit. With the removal of this tool, the IRS will most likely find some other method of monitoring and enforcement.

We may see the IRS requiring that all reimbursements be reported on the W-2 with a corresponding form in which the taxpayer is required to validate the amount of reimbursements that they received. We may also see an increased number of audits simply by association. Since the IRS is aware that the staffing industry has historically stumbled in reimbursement policy compliance, taxpayers may be chosen for audits simply by who they work for. This means that even though records do not need to be kept for deductions, they should be kept for 7 years to justify the tax-free reimbursements received.

EDUCATION

The American Opportunity Tax Credit, Lifetime Learning Credit and Student Loan Interest were left untouched by the new rules. However, the Tuition and Fees deduction has been removed. This was a deduction that was allowed for higher income individuals for college courses. Some healthcare professionals working on their bachelor's degrees or an advanced degree that was required for them to continue working in their current capacity were able to use the employee business expense deduction for the entire amount of their tuition. That of course, is no longer an option.

HEALTHCARE INSURANCE MANDATE

Starting in 2019, the tax penalty for not having health insurance is gone.

MEDICAL EXPENSES

Medical expenses are still allowed as a deduction if they exceed 7 ½% of the taxpayer's adjusted gross income. The 7 ½% rate is retroactive to 2017 tax returns which is a change from the 10% threshold required in the previous laws. Taxpayers over 65 are still able to deduct medical expenses more than 7 ½% of their income.

EVERYTHING MAY CHANGE

Tax laws change all the time - as one tax professional said, following tax laws is like following a dog wagging their tail.

The tax reform bill was passed without one vote from a Democrat. This is the same scenario that allowed the Affordable Care Act to be passed (aka Obamacare). When ACA was passed, not one Republican voted for it. Then as now, there was one party controlling Congress and the presidency. The party in control used what is known as the "reconciliation process" to pass the laws with only a simple majority in the Senate. Normally an opposing party can filibuster a bill in the Senate requiring a 60-vote majority to clear debate. Under the reconciliation rules, only a simple majority of 51 senators is required.

The current Congress is dismantling ACA. What will happen in a few years if the Democrats take control of Congress and the presidency? Or the makeup of Congress is averse to many of the components of the tax reform bill? We may see a dismantling of tax reform as well.

Additionally, there are bound to be modifications going forward. As many taxpayers file their returns in 2019 and see the affects Congress may act accordingly to change some rules that had unintended consequences.

WHAT WILL THE STATES DO?

This is the great mystery. State tax laws will surely respond to the new federal rules. Most state tax returns start with some number pulled from the federal tax return and many of the deductions allowed by the state revenue agencies follow the Federal return. Currently, many states are still allowing employee business expenses. Since the tax reform bill was passed at the very end of 2017. State legislatures have not had time to review the impact of the bill on their tax revenue.

Regardless of how the states respond, it is still the state tax returns that give travelers the greatest audit concerns. State revenue agencies have been very aggressive in auditing residency, reimbursements and cross reference professional license rosters with return filings. That will not stop with tax reform and may very well increase.

OTHER ITEMS

If you have read this far you deserve a coffee break :-). The following are a list of miscellaneous items that have changed in this tax reform bill which are not traveler specific but bear mention.

- 1) Alimony is no longer deductible nor required to be claimed on the tax return as income for divorces executed after 2018
- 2) Moving expenses are no longer deductible nor allowed as a tax-free benefit by the employer
- 3) State and local taxes which include property, real estate, income taxes will be capped at 10,000 total per year as an itemized deduction. This stands to hurt those with higher incomes, especially those working in California and other states with high property and income taxes.
- 4) Section 529 tuition savings accounts are now allowed to be used for private elementary and secondary schools. This is a fantastic benefit for those who find the public-school offerings lacking for their children, especially those with special needs. Unfortunately, this was not extended to homeschoolers thanks to Sen. Schumer of New York.
- 5) Casualty losses can only be claimed if you are in a presidential disaster area - this is retroactive to 2017.
- 6) Home equity loan interest is no longer deductible. If you have sufficient equity, consolidating the loan may be beneficial
- 7) Tax brackets are now lower. Previously, they were 10,15,25,28,33,35, and 39.6%. Now they are 10,12,22,24,32,35 and 37%
- 8) Marriage penalty is gone
- 9) Child tax credit goes to 2K but the personal exemption is gone making this less meaningful
- 10) Since the personal exemption is gone, a new \$500 credit for other dependents is in place. Those with large families will see an increase in their taxes with the removal of the personal exemption.
- 11) Companies can no longer deduct attorney fees related to sexual harassment cases

CONCLUSIONS

The tax reform legislation has changed a lot of the assumptions that many Americans have taken for granted as they plan for their future. At the same time there are new opportunities for tax savings that should be explored. We offer these parting suggestions as we close.

- 1) Live frugally. The best way to make money in traveling is to find housing that is cheaper than your housing stipend and eat cheaper than your meal allowance. Avoid corporate housing if possible.
- 2) Even though #1, applies, spending money for a tax deduction or tax-free benefit rarely improves your bottom line

- 3) Since employee business expenses are no longer deductible, that does not justify low ball wage rates that maximize reimbursements. Social Security, home loans, workers compensation and audit risk are still affected by a low taxable contract.
- 4) Rouge agencies are apt to emerge and take advantage of the temporary compliance gap and offer excessive tax-free amounts. Avoid these.
- 5) Keep receipts to justify your reimbursements for 7 years
- 6) Make sure your state returns are properly prepared and filed. Most tax professionals only prepare one to three states and few file in every state. Getting ALL the states right is very important as a traveler leaves a cookie trail with all their activity. (Remember, if you are maintaining a tax home, you should NOT file as part year resident in every state you work.)
- 7) Ask for additional reimbursements for licenses, CEUS, uniforms, equipment and other items you will need for your contract
- 8) Ask for increased travel pay when the capped rate does not reach the IRS standard mileage rate (54.5c per mile in 2018) plus en-route lodging.
- 9) Use the tax savings to pay off debt
- 10) Make sure your tax home is solid