What’s New This Tax Season?

Overall, there are two types of changes you should be aware of when preparing your tax return:

1. The IRS Form 1040 tax return has been overhauled, and new schedules (supplementary forms) have been added. Forms 1040A and 1040 EZ have been eliminated.

2. The tax reform legislation that took effect in 2018 (the Tax Cuts and Jobs Act) affects the tax rates that apply to stock compensation.

Here are the details:

**Overhauled IRS Form 1040**

The IRS has undertaken a major reorganization and streamlining of the Form 1040 tax return, condensing it to just 23 lines. Using what it calls a “building block” approach, the IRS created six new schedules (supplementary forms) that funnel information to Form 1040. Under this new format, filers first enter many of the numbers they previously reported on Form 1040 on these schedules.

**Tax-Reporting Changes**

The tax treatment for stock compensation and sales of company stock remains the same. Where and how filers report this information on their tax return has changed as follows:

1. **Reporting compensation.** Stock compensation is now reported on Line 1 of Form 1040 along with salary income.

2. **Reporting stock sales.** When filers report a sale of company stock, they still enter it on Form 8949 and enter the totals from Form 8949 on Schedule D.
   - Totals from Schedule D are now entered on Line 13 of the new Schedule 1 (“Additional Income and Adjustments to Income”).
   - Totals from Schedule 1 funnel into Form 1040 as part of the amount reported on Line 6 (“Total income”).

3. **Reporting other income.** The new Schedule 1 is also where filers report any stock compensation income not included on Form W-2. This can happen under certain circumstances, such as in a qualifying disposition of stock from an Employee Stock Purchase Plan (ESPP). Filers will report the amount on Line 21 (“Other income”) of Schedule 1 with a short explanation, such as “income at sale of ESPP stock from [X corporation].”
4. Reporting the Alternative Minimum Tax (AMT). AMT, which can be a concern for people with incentive stock options (ISOs), is now reported as follows:

- The AMT, if owed based on the Form 6251 calculation, now goes into Line 45 of Schedule 2 (“Tax”). The totals from this schedule go into Line 11 of Form 1040.

- The spread at ISO exercise is reported on Line 2i. When the ISO stock that triggered the AMT is sold, the difference from the ordinary tax is reported on Line 2k.

- The AMT credit generated from an ISO exercise that triggers the AMT is recouped through Form 8801. The amount from Line 25 of Form 8801 now goes on Schedule 3 (“Non-Refundable Credits”), Line 54 (check box b). The totals from Schedule 3 go into Line 12 of Form 1040.

Rules for Cost-Basis Reporting

For stock sales, there is no change in the IRS rules about how the cost-basis information is reported on Form 1099-B. For grants made in 2014 and later years, brokers are prohibited from including equity compensation income (which appears on Form W-2) in the cost basis reported on Form 1099-B.

For information on the tax return reporting for sales of shares acquired through stock compensation, including annotated diagrams of Form 8949 and Schedule D, see the tax guides and supplemental information provided by Fidelity.

The Tax Cuts and Jobs Act

The tax law contains some provisions that impact taxes related to stock compensation that filers may be paying on their tax return.

1. Changes in the rates of individual income tax. The Tax Cuts and Jobs Act kept the current seven income tax brackets, but reduced the rates and changes the income thresholds that apply. The rates are now 10%, 12%, 22%, 24%, 32%, 35%, and 37%, with the top bracket starting at $600,000 for joint filers ($500,000 for single filers).

This means lower tax rates for compensation income, interest, ordinary dividends, and short-term capital gains.

Withholding

The flat supplemental wage rate for federal income tax withholding on stock compensation is based on the seven brackets. For amounts up to $1 million, it’s linked to the third-lowest rate (22%). For amounts over $1 million, it’s linked to the highest rate (37%).

As shown in the table below, the 22% rate of withholding (lowered from 25%) may not cover the actual taxes due on the additional taxable income from stock compensation in 2018. Unless filers paid estimated taxes during 2018 to cover any meaningful shortfall, they may owe an additional amount with their tax return. Discuss this with a tax professional.

<table>
<thead>
<tr>
<th>2018 Rate</th>
<th>2018 Taxable Income (Single)</th>
<th>2018 Taxable Income (Joint)</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$0 to $9,525</td>
<td>$0 to $19,050</td>
</tr>
<tr>
<td>12%</td>
<td>$9,526 to $38,700</td>
<td>$19,051 to $77,400</td>
</tr>
<tr>
<td>22%</td>
<td>$38,701 to $82,500</td>
<td>$77,401 to $165,000</td>
</tr>
<tr>
<td>24%</td>
<td>$82,501 to $157,500</td>
<td>$165,001 to $315,000</td>
</tr>
<tr>
<td>32%</td>
<td>$157,501 to $200,000</td>
<td>$315,001 to $400,000</td>
</tr>
<tr>
<td>35%</td>
<td>$200,001 to $500,000</td>
<td>$400,001 to $600,000</td>
</tr>
<tr>
<td>37%</td>
<td>Over $500,000</td>
<td>Over $600,000</td>
</tr>
</tbody>
</table>
2. Changes in the calculation of the Alternative Minimum Tax (AMT). The income spread at incentive stock options (ISOs) exercise can trigger the AMT. Below are the new numbers in the AMT calculation (adjusted annually for inflation).

- The 2018 AMT income exemption amount increased to $70,300 for single filers and to $109,400 for married joint filers.

- The income where this AMT income exemption starts to phase out in 2018 is substantially adjusted upward, to begin at $500,000 for individuals and $1,000,000 for married couples.

These higher AMT income exemption amounts, and the much higher income point where the phase-out starts, make it much less likely that ISOs will trigger the AMT.

3. Changes in the income threshold for long-term capital gains. While there is no change in long-term capital gains rates, the tax law created a new income threshold for when the rate on long-term capital gains and qualified dividends goes from 15% to 20% (more than $479,000 for married joint filers and $425,800 for single taxpayers).

For more information, refer to Fidelity’s stock plan guides at Understanding taxes. Or call 800.544.9354 to speak with an experienced Fidelity Stock Plan Services representative.