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CLIENT NEWSLETTER

THE TAX CUTS AND JOBS ACT OF 2017

Happy New Year!

On December 22, 2017 the "Tax Cuts and Jobs Act" of 2017 was enacted by Congress and signed into law. The new law changes many fundamental aspects of the tax law as we know it. As a result, each person's situation is unique, so it's not practical to give generalized advice. Call or write to us about your specific situation.

Most of the changes take effect in 2018, but some are retroactive to various dates in 2017, and the rest take effect in 2019. The changes to corporate taxes are permanent, whereas most changes to individual taxes expire at the end of 2025, after which most individual tax rules will revert to 2017 law. The tax cuts of 2001 & 2003 also had an expiration date (2010), but Congress refused to permit the laws to revert to 2001 as this would have been viewed as a "tax increase", and no member of Congress wanted to be labeled as one who increased taxes. It is quite likely that the 2025 expiration will also not occur; many Senators have said so.

Many experts and politicians have expressed opinions about this bill, both in favor and against. Regardless of how you feel, one thing is certain: As the public only received the full text of this new law late Friday night, December 15, we are still not entirely sure of its short- and long-term effects. While President Reagan's 1986 Tax Reform Act was publicly debated for almost 4 years before being enacted, this legislation had far less scrutiny before passage. With 509 pages of law and 588 pages of explanations by Senate/House Joint Committee on Taxation, a total of 1,097 pages, the new law requires more time to be fully examined as to its effects.

What's In the New Law

The primary thrust of new law affects individuals and businesses. There are limited changes for non-for-profit organizations and other entities. Since most of our clients are individuals and small businesses we will focus on those provisions. We have summarized most of the changes in a table at the end of this Newsletter. All reference to forms and line numbers are to 2016 Form 1040 and its schedules. You can look at your individual numbers while you read this Newsletter.

Individuals

Many items change for 2018 due to the usual annual inflation adjustments. These are also shown in the table at the end of this Newsletter. Please note that beginning in 2019, inflation adjustments will be calculated differently than in the past, resulting in smaller inflation adjustment in nearly all areas of the tax law, including Social Security.

Income tax **Exemptions** for yourself, spouse, and dependents **are repealed** in 2018. You will no longer get a deduction of $4,150 per person on your 2018 tax return. This might be somewhat offset by the increased Standard Deduction.

The **Standard Deduction increases** as follows:

	2017	Old Law 2018	New Law 2018
Married filing jointly	$12,700	$13,000	$24,000
Single or Married/Separate	$ 6,350	$ 6,500	$12,000
Head of Household	$ 9,350	$ 9,550	$18,000

The additional Standard Deduction if you are blind and/or over age 65 remains at the inflation adjusted 2018 amounts of $1,300 per spouse, or $1,600 if unmarried. These are added to the table amounts above.

The **Alternative Minimum Tax Exemption** amounts are increased thereby eliminating this tax for many middle income taxpayers. Starting in 2019 the exemption amounts will be indexed for inflation.

	2017	Old Law 2018	New Law 2018
Married filing jointly	$84,500	$86,200	$109,400
Married/Separate	$ 42,500	$43,100	$ 54,700
Single or Head of Household	$ 54,300	$55,400	$ 70,300

Medical Expenses have been deductible to the extent the total exceeded 10% of Adjusted Gross Income (Form 1040, Line 37), or 7.5% for people over 65. Under the Old Law, the percentage was supposed to be 10% for everyone in 2017. The New Law changes the percentage back to 7.5% for everyone, but only in 2017 and 2018; it reverts back to 10% in 2019.

Deduction for **State and Local Taxes** has been limited starting in 2018. The total amount of state/local income taxes, sales taxes, real estate taxes, and personal property taxes that may be deducted is $10,000. This will be particularly hurtful in states that have high state income taxes and/or real estate taxes, such as NY, NJ, CA, CT, MA, IL, OR and others. Foreign real estate taxes may not be deducted at all. However property taxes and sales taxes incurred in a business or income-producing activity are allowed as a deduction. If you are self-employed, call or write to discuss this.

Deduction for **Mortgage Interest:** Under the old law you could deduct the interest on up to $1,000,000 of mortgage debt, plus on $100,000 of a home equity line of credit. For mortgages initiated on or after December 15, 2017, the limit is the interest on $750,000 of debt. The interest on **home equity lines of credit** is not deductible starting in 2018. (If there was a binding contract for a mortgage before 12/15/17 but the mortgage closes after that date, then so long as the mortgage closes by March 31, 2018, the old $1,000,000 will be allowed.) If a mortgage incurred before 12/15/17 is re-financed at a later date, the old rules apply so long as the new mortgage does not exceed the remaining balance of the old mortgage.

Deductions Repealed as of 2018: All so-called "Job Expenses and Certain Miscellaneous Itemized Deductions" (Lines 21 to 27 of the 2016 Schedule A and Form 2106) are repealed. This includes:

- Employee business expenses such as *unreimbursed* use of personal vehicle, travel, hotels, home office, meals, entertainment, and more.
- Fees for tax preparation and advice.
- Disaster losses such as theft, fraud, fire, storm damage, etc. except in areas designated by the President as Federal Disaster Areas.
- Investment management, advisory, and custodial fees.
- Safe deposit box rentals.
- And more.

Also repealed in 2018 is the deduction for job-related **Moving Expenses** (Form 3903 and Form 1040, Line 26).

The **Health Care Individual Responsibility Tax**, that is, the additional tax you were required to pay if you did not have health insurance (Form 1040, Line 61) is effectively repealed by reducing the tax rate to Zero starting in 2019.

The **Child Tax Credit** (Form 1040, Line 52) is increased from $1,000 to $2,000 per qualifying child. Also added is a $500 credit for each dependent who is not a child, such as a parent. Up to $1,400 per child can be a **"refundable"** credit (Form 1040, Line 67). A "refundable" credit is treated as if it were a pre-payment of tax (such as withholding tax or estimated tax), and can therefore be refunded even if it exceeds your tax. Child tax credits begin to phase-out when taxable income exceeds $400,000 (married/joint) or $200,000 (single).

New 20% deduction for income received from so-called **"Pass-through Entities."** A pass-through entity is an organization such as a partnership, S-corporation, a business owned by one individual, a Real Estate Investment Trust ("REIT"), and in some cases, an ordinary trust. Unlike regular corporations which pay income tax on their profits, pass-through entities do not. Instead, each owner of a pass-through entity is taxed on his/her share of the entity's profits. This amount passes through to the owners' tax returns where it is taxed like regular income; that is, at the owner's normal income tax rate.

The new law provides for a deduction by each owner of 20% of his/her profit from pass-through entities. The 20% deduction begins to phase out when the owner's Taxable Income (Form 1040, Line 43) exceeds $315,000 (married filing jointly) or $157,500 (single).

If you are the owner or part-owner of a business, this can be of great benefit to you. In some cases it may be possible for people earning salaries or wages to become "businesses" and get this benefit (and also restore the repealed employee business expenses). However, changing from being an "employee" to a non-employee can cause you to lose many fringe benefits such as 401(k) plan, employer paid health insurance plan, life insurance, sick pay, and others. Purchasing health insurance independently (rather than through an employer) is generally much more expensive. Talk to us if want to consider this and you think your employer might be willing to make such an arrangement with you.

The **"Kiddie Tax"** has been revised. Under the old law, the unearned (that is, income not from working) income of a child under age 19 that exceeded $2,100 was taxed at the higher of the child's tax rate or the parents' tax rate. Beginning in 2018, the child's earned income is taxed at normal Single Person rates, and the child's unearned income is taxed at the Estate and Trust rates, which are the very highest rates.

Capital Gains rates and the rates for Qualified Dividends remain at 0%, 15%, or 20% depending upon taxable income. The break points between the three rates have been modified slightly.

Business Losses of individuals can no longer be carried back to prior years, but must be carried forward. In addition, business losses in excess of $500,000 (married/joint) or $250,000 (single) cannot be deducted in the current year, but can only be carried forward.

Alimony: Effective 2019, alimony received is not income and alimony paid is not deductible for arrangements executed after 12/31/18.

The overall **limitation on itemized deductions** for high income individuals is repealed.

Section 529 Plans can be used to fund K-12 private school education up to $10,000 per year.

The combined **Estate and Lifetime Gift Tax Exemption** jumps from $5,490,000 per person to $11,200,000 per person; double those amounts for married couples. This means that only a tiny number of Americans will be subject to the Estate Tax. The **Annual Gift Tax Exclusion** gets its first inflation increase in many years, rising from $14,000 to $15,000 in 2018. This means that you can make gifts of $15,000 or less to as many individuals as you wish without being required to file a Gift Tax Return. Even if you *are* required to file a Gift Tax Return, your tax will most likely be zero because of the $11,200,000 Lifetime Exemption.

<u>Business Taxes</u>

The **tax rate** for regular corporations (not S-Corporations) is 21% effective in 2018, replacing a graduated rate system whose highest rate was 35%.

Depreciation: The 50% "bonus" depreciation on new equipment is increased to 100% in for property placed in service on or after 9/28/17 and on or before 12/31/22, meaning that businesses can completely deduct the cost of newly acquired equipment. In addition, the newly acquired equipment does not have to be new; it can be used. The same applies to Section 179 depreciation. The limitation on write-offs under Section 179 has been increased from $500,000 to $1,000,000 per year.

Entertainment expenses are **not deductible** starting in 2018.

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Please call or write if you have any questions or concerns.

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Summary of Most Changes

	2017	2018
Auto mileage rate for business	53.5¢ per mile	**54.5¢** per mile
Auto mileage rate for medical & moving expenses	17.0¢ per mile.	**18.0¢** per mile for medical. Moving expense not deductible.
Auto mileage rate for charity	14¢ per mile	14¢ per mile
Long-Term Capital Gains Rates	0%, 15%, 20%	0%, 15%, 20%
Maximum IRA & Roth IRA contribution	$5,500 + $1,000 if over age 55.	$5,500 + $1,000 if over age 55.
Maximum SEP & other defined contribution plans	Lesser of $54,000 or 25% of compensation	Lesser of $54,000 or 25% of compensation
Maximum 401(k),403(b),457 Plan contribution limit	$18,000 + $6,000 if over age 55.	$18,000 + $6,000 if over age 55.
Maximum wages taxable for Social Security	$127,200. Maximum employee tax = $7,886.40	**$128,400**. Maximum employee tax = **$7,960.80**
Social Security Tax Rate Medicare Tax Rate	6.2% 1.45%	6.2% 1.45%
Annual Gift Tax Exclusion (per person receiving gifts)	$14,000	**$15,000**
Estate Tax Exemption per person	$5,490,000	**$11,200,000**
Personal & Dependent Exemption	$4,050	**Zero**
Standard Deduction	Married: $12,700; Single: $6,350; Head of Household: $9,350	Married: **$24,000**; Single: **$12,000**; Head of Household: **$18,000**
Additional Standard Deduction for Age 65 or Blind	Married: $1,250 per spouse. Unmarried: $1,550	Married: $1,250 per spouse. Unmarried: $1,600
Alternative Minimum Tax Exemption	Married: $84,500; Single or Head of Household: $54,300; Married filing Separately: $42,2500	Married: **$109,400**; Single or Head of Household: **$70,300**; Married filing Separately: **$54,700**
Foreign Earned Income Exclusion	$102,100	**$104,100**
Flexible Benefit Account Maximum	$2,600	$2,600
Medical expenses	Amount exceeding 10% of Adjust Gross Income is deductible. Changed to 7.5% for 2017 and 2018.	Amount exceeding **7.5%** of Adjust Gross Income is deductible. Increases to **10%** in 2019.
Maximum deduction for State and Local taxes	No limit	**$10,000**

	2017	2018
Deduction for income from "Pass-Through" entities such as LLCs, Partnerships, S Corporations, Trusts	None	**20% of net income.** State income tax effects of this deduction will vary greatly from state to state,
Maximum mortgage on which interest can be deducted	$1,000,000	**$750,000** effective 12/15/17
Maximum Home Equity Line of credit on which interest can be deducted	$100,000	**Zero**
Deductions Repealed: >Tax preparation fees >Investment advisory fees >Agents' commissions >Employee business expenses (including home office expenses of employee) >Moving expenses >All others that were subject to the 2% of income limit	Total that exceeds 2% of Adjust Gross Income	**Zero**
Additional tax for not having Health Insurance under the Affordable Care Act	Various	**Zero**
Child Tax Credit	$1,000 per child. Up to $3,000 is refundable meaning it can be refunded even if you have no tax.	**$2,000** per child. Up to **$1400** per child is "refundable" meaning it can be refunded even if you have no tax.
"Like-Kind" Exchanges	Allowed	Allowed only for real estate. Trade-in of *business* automobile will be a taxable gain or loss.
Business Entertainment	Allowed (50%)	Not allowed.

Disclaimer: This Newsletter is for informational purposes only and is not a substitute for obtaining professional tax and legal advice that is specific to each taxpayer's individual circumstances.