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Balance sheet

Major Tax Reform?

By Ann E. Woolum, CPA/ABV, CBA

Congress appears poised to enact a major tax reform law that could potentially make fundamental changes in the way you and your family calculate your federal income tax bill, and the amount of federal tax you will pay. This letter is designed to help you cope with the changes Congress is hammering into shape right now in order to take advantage of tax breaks that may be heading your way, and to soften the impact of any crackdowns. Keep in mind, however, that while most experts expect a major tax law to be enacted this year, it is by no means a sure bet. So keep a close eye on the news and do not swing into action until the ink is dry on the President's signature of the tax reform bill.

As Congress prepared to begin the process of reconciling its various tax reform bills, the final shape of the Senate's Act gave important clues as to the shape the changes to the Tax Code may ultimately take. With those changes as a guide, it is possible to compare the two acts and get a much clearer idea of where Congress can – and cannot – reach a consensus. With that in mind, here are six things that are highly likely to be part of any final tax reform legislation.

1. **Lower corporate tax rates.** Lowering the overall rate for businesses is a core goal of GOP leaders, and is included in both the Senate and House bills. The aim of both is to take the overall rate from 35 percent down to 20 percent; the Senate nixed a proposal to raise the rate to 22 percent. That said, the House proposal would institute the cuts in 2018, while the Senate would postpone them to 2019.
2. **An increased personal standard deduction.** Both bills would significantly boost this to $12,000 for individuals and $24,000 for married couples.
3. **Goodbye to the personal exemption.** The House and the Senate agree on eliminating the current $4,050 personal exemption that taxpayers can claim for themselves, their spouses and each of their dependents.
4. **A higher estate tax exemption.** Both the House and Senate bills double the size of estates that are subject to the estate tax – from approximately $5.5 million to $11 million. The House wants to kill the so-called "Death Tax" entirely after six years, however, while the Senate wants to leave it in place.
5. **Keeping a partial real estate tax deduction.** The Senate bill had originally eliminated all deductions for state and local taxes; but at the last minute kept the maximum $10,000 deduction for state and local property taxes (but not income or sales taxes). This brought the Senate bill in line with the House proposal.

For all those areas of agreement, some differences still remain to be discussed in the conference committee. Among the most important of them are:

- **Tax brackets:** The House wants four, the Senate wants seven, but at lower rates; they will need to work out their differences to make any changes here.
- **Pass-through entities:** The final treatment of pass-through entities remains uncertain. The Senate bill increased the proposed amount of profits that pass-through owners can deduct from around 17 percent to 23 percent; the House would tax pass-through entities at 25 percent, but only after complex calculations depending on whether the taxpayer is an active or a passive participant in the business. (The House also would not allow service pass-through entities, like accounting firms, to take advantage of the lower rate.) Expect wrangling over these details.
- **Mortgage interest deduction:** The House wants to only allow the deduction for mortgage interest for loans up to $500,000, while the Senate bill would leave the deduction available for home loans of up to $1,000,000, the current limit.
- **The AMT.** The House would kill the Alternative Minimum Tax entirely, but the Senate dropped plans to do the same, opting instead only to adjust it, to raise revenue.

The general plan of action to take advantage of lower tax rates next year would be to defer income into next year. Some possibilities follow:

- If you are an employee who believes a bonus is coming your way before year end, consider asking your employer to delay payment of the bonus until next year.
- If you are thinking of converting a regular IRA to a Roth IRA, postpone your move until next year. That way you will defer income from the conversion until next year and hopefully have it taxed at lower rates.
- If you run a business that renders services and operates on the cash basis, the income you earn is not taxed until your clients or patients pay. So if you hold off on billings until next year or until so late in the year that no payment can be received this year, you will succeed in deferring income until next year.
- If your business is on the accrual basis, deferral of income till next year is difficult but not impossible. For example, you might, with due regard to business considerations, be able to postpone completion of a job until 2018, or defer deliveries of merchandise until next year. Taking one or more of these steps would postpone your right to payment, and the income from the job or the merchandise, until next year. Keep in mind that the rules in this area are complex and may require a tax professional's input.
- The reduction or cancellation of debt generally results in taxable income to the debtor. So if you are planning to make a deal with creditors involving debt reduction, consider postponing action until January to defer any debt cancellation income into 2018.

Disappearing deductions, larger standard deduction. Beginning next year, both the House-passed tax reform bill and the version before the Senate would repeal or reduce many popular tax deductions in exchange for a larger standard deduction. Here is what you can do about this right now:

- Since the deduction for nonbusiness state and local income or sales tax would disappear in 2018 and you expect to owe state and local income taxes when you file your return next year, consider asking your employer to increase withholding on those taxes. That way, additional amounts of state and local taxes withheld before the end of the year will be deductible in 2017. Similarly, pay the last installment of estimated state and local taxes for 2017 by Dec. 31 rather than on the 2018 due date. You may want to consider prepaying real estate taxes on your home.

- It appears that the itemized deduction for charitable contributions will remain intact. But because most other itemized deductions would be eliminated in exchange for a larger standard deduction (e.g., $24,000 for joint filers), charitable contributions after 2017 may not yield a tax benefit for many. If you think you will fall in this category, consider accelerating some charitable giving into 2017.
- The House-passed bill, but not the one before the Senate, would eliminate the itemized deduction for medical expenses. If this deduction is indeed chopped in the final tax bill, and you are able to claim medical expenses as an itemized deduction this year, consider accelerating "discretionary" medical expenses into this year. For example, order and pay for new glasses, arrange to take care of needed dental work, or install a stair lift for a disabled person before the end of the year.

Other year-end strategies. Here are some other "last minute" moves that could wind up saving tax dollars in the event tax reform is passed:

- If you are in the process of selling your principal residence and you wrap up the sale before year end, up to $250,000 of your profit ($500,000 for certain joint filers) will be tax-free if you owned and used the property as your main home for at least two of the five years before the sale. However, under the House-passed bill and the bill before the Senate, the $250,000/$500,000 tax free amounts would apply to post-2017 sales only if you own and use the property as your main home for five out of the previous eight years.
- Under current rules, alimony payments generally are an above-the line deduction for the payor and included in the income of the payee. Under the House-passed tax bill but not the version before the Senate, alimony payments would not be deductible by the payor or includible in the income of the payee, generally effective for any divorce decree or separation agreement executed after 2017. So if you are in the middle of a divorce or separation agreement, and you will wind up on the paying end, it would be worth your while to wrap things up before year end if the House-passed bill carries the day. On the other hand, if you will wind up on the receiving end, it would be worth your while to wrap things up next year.
- Both the House-passed bill and the version before the Senate would repeal the deduction for moving expenses after 2017 (except for certain members of the Armed Forces), so if you are about to embark on a job-related move, try to incur your deductible moving expenses before year-end.

Please keep in mind that only some of the year-end moves have been described that should be considered in light of the tax reform package currently before Congress—which, it bears emphasizing, may or may not actually become law. If you would like more details about any aspect of how the proposed legislation may affect you, please do not hesitate to call.