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Balance sheet

TAX PLANNING UNDER THE TAX CUTS AND JOBS ACT

By Ann E. Woolum, CPA/ABV, CBA

Year-end planning for 2018 takes place against the backdrop of a new law — the Tax Cuts and Jobs Act (TCJA) — that made major changes in the tax rules for individuals and businesses. For individuals, there are new, lower income tax rates, a substantially increased standard deduction, severely limited itemized deductions and no personal exemptions, an increased child tax credit, and a watered-down alternative minimum tax (AMT), among many other changes. For businesses, the corporate tax rate is cut to 21%, the corporate AMT is gone, there are new limits on business interest deductions, and there are significantly liberalized expensing and depreciation rules. In addition, there is a new deduction for non-corporate taxpayers with qualified business income from pass-through entities.

Despite this atmosphere of change, the time-tested approach of deferring income and accelerating deductions to minimize taxes still works for many taxpayers, along with the tactic of "bunching" expenses into this year or the next to get around deduction restrictions. For individuals, deferring income also may help minimize or avoid phase-outs of various tax breaks based on a taxpayer's adjusted gross income (AGI). As always, however, year-end tax planning does not occur in a vacuum. It must take account of each taxpayer's particular situation and planning goals, with the aim of minimizing taxes to the greatest extent possible. While most taxpayers will come out ahead by following the traditional approach, others with special circumstances may do better by accelerating income and deferring deductions.

Another reminder is to consider using a credit card to pay deductible expenses before the end of the year. When you charge the transaction, it is considered a deductible expense on the date of the charge. Doing so will increase your 2018 deductions even if you do not pay your credit card bill until the year 2019.

Unless noted, the effective date for the changes under the new tax law is January 1, 2018 with a sunset date of December 31, 2025. The following summarizes the significant changes as result of the new tax law:

- **Change in tax rates.** The corporate tax rate is permanently changed to a flat rate of 21%. Individual tax rates are also reduced while the maximum capital gains tax rates and qualified dividend tax rates remain the same. The net capital losses remain capped at $3,000 annually.
- **Changes in itemized deductions.** With the increase in the standard deduction amount, fewer taxpayers will itemize. If your total annual itemized deductions for 2018 will be close to your standard deduction amount, consider making additional expenditures before year-end to exceed the standard deduction amount.

One suggestion is to bunch charitable contributions in alternating years. This will lower your tax bill in the year you itemize. The next year, you can claim the standard deduction, which will be increased a bit to account for inflation.

- **Medical expenses.** The medical expense floor is reduced to 7.5% of adjusted gross income for 2018 and reverts back to 10% for 2019 and later.
- **State and local taxes.** The deduction for real estate taxes and state and local income taxes or sales tax has been limited to $10,000.
- **Mortgage interest.** The ceiling on acquisition indebtedness was reduced to $750,000 effective December 15, 2017. For mortgages existing before December 15, 2017, the prior limit of $1,000,000 still qualifies. Home equity indebtedness is no longer deductible unless the proceeds were used to improve the home and is included in the overall mortgage limitation of $750,000.
- **Charitable contributions.** For the most part, the charitable contribution deduction remains the same except that the threshold limitation was increased to 60% from 50% of adjusted gross income.
- **Casualty and theft losses.** The personal casualty and theft loss deduction was eliminated except for losses attributed to federally-declared disasters.
- **Miscellaneous itemized deductions.** All miscellaneous itemized deductions subject to the 2% floor are eliminated through 2025. This includes tax preparation fees, unreimbursed business expenses, investment expenses, and home office for an employee working from home.

- **Other important changes.**
  - **Moving expenses.** The moving expense deduction has been eliminated except for active members of the Armed Forces. The exclusion from gross income for reimbursement of moving expenses has been suspended.
  - **Alimony.** For divorce or separation agreements executed after December 31, 2018, a deduction for alimony paid has been eliminated, and, therefore makes all alimony received nontaxable.
  - **Alternative minimum tax.** The AMT exemption amount increase to $109,400 for married taxpayers filing a joint return and $70,300 for all other taxpayers. In addition, the exemption threshold phase-out was increased, so it is expected that fewer people will be subject to the AMT tax.
  - **Higher education expenses.** The definition of qualified higher education expenses has been modified to allow distributions of up to $10,000 per student from a Section 529 account for tuition and other eligible expenses at elementary or secondary schools. This does not sunset after 2025.
  - **IRAs.** Effective January 1, 2018, taxpayers who convert a traditional pre-tax IRA into a post-tax Roth IRA may no longer reverse the conversion; this was typically done if the value of the conversion had declined. The new law still allows annual Roth IRA contributions to be recharacterized as traditional IRA contributions as long as the recharacterization is completed by the due date of the tax return. Consistent with prior law, conversion of a traditional IRA to a Roth IRA triggers immediate taxation.
  - **Health insurance penalty.** The individual responsibility payment with respect to health coverage status was enacted as part of the Affordable Care Act. The TCJA reduced the amount of the individual responsibility payment to zero for months beginning after December 31, 2018 and before January 1, 2026; however, the 3.8% investment income tax was retained.

- **Estate tax exemption.** Effective for deaths and gifts made after December 31, 2017 through December 31, 2025, the estate exemption for decedents dying in 2018 is $11,180,000. Do not overlook estate planning. Even though these big exemptions may mean you are not currently exposed to federal estate tax, your estate plan may need updating to reflect the current tax rules. More importantly, you may need to make some changes for reasons that have nothing to do with taxes. In addition, you may make annual gifts of up to $15,000 to each of an unlimited number of individuals during 2018 with no gift tax.

- **Changes affecting business owners of pass-through entities.** The TCJA established a new deduction based on an individual's qualified business income. The new law provides that an individual taxpayer generally may deduct 20% of "qualified business income" from a partnership, S corporation, sole proprietorship, or farm, as well as 20% of the aggregate qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income. This deduction is subject to various rules and limitations such as restrictions that can apply at higher income levels and another restriction based on the owner's taxable income.
- **Changes affecting like-kind exchanges.** Under prior law, IRS Code Section 1031 allowed for tax-deferred exchanges of like-kind property. Effective January 1, 2018, tax-deferred exchanges are no longer allowed for personal property assets; however, tax deferral is still allowed for like-kind exchanges involving real estate transactions.
- **Liberalized depreciation tax breaks.** The TCJA included a number of very favorable changes to the depreciation tax rules, including 100% first-year bonus depreciation for qualifying assets and much more generous Section 179 deduction rules. Expensing is generally available for most depreciable property, other than buildings. Expensing is also available for roofs, HVAC, fire protection, alarm, and security systems, and qualified improvement property (generally, any interior improvement to a building's interior, but not for enlargement of a building, elevators or escalators, or the internal structural framework). Contact us for additional details and how your business can take advantage of these new changes.

The TCJA of 2017 is the biggest tax reform enacted in over thirty years comprising about 130 new tax provisions. The Treasury states that the "Postcard" will take less time to complete. This most likely is not true since extra forms will be needed to complete the 2018 return for many taxpayers. Since the Treasury is advocating the 2018 returns are easier to complete, taxpayers may be anticipating a lower tax preparation fee. With the significant number of changes, especially if you are eligible for the new deduction for pass-through business income, we do not anticipate returns being easier to prepare. Therefore, we anticipate that our tax return preparation fee could likely increase.

The above only covers some of the year-end tax planning moves that could potentially benefit you and your business. Please contact us if you have questions or would like us to help you with year-end planning.