Coleman & Associates
Fully Integrated Tax, Accounting & Financial Services

Newsletter

New Tax Bill – Important Changes

The recently enacted Tax Cuts and Jobs Act (TCJA) is a sweeping tax package. This newsletter first summarizes some of the important changes effecting individuals and then lists some possible last-minute saving opportunities.

Summary of Changes

Here's a look at some of the more important elements of the new law that have an impact on individuals. Unless otherwise noted, the changes are effective for tax years beginning in 2018 through 2025.

- **Tax rates**. The new law imposes a new tax rate structure with seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top rate was reduced from 39.6% to 37% and applies to taxable income above $500,000 for single taxpayers, and $600,000 for married couples filing jointly. The rates applicable to net capital gains and qualified dividends were not changed. The "kiddie tax" rules were simplified. The net unearned income of a child subject to the rules will be taxed at the capital gain and ordinary income rates that apply to trusts and estates. Thus, the child's tax is unaffected by the parent's tax situation or the unearned income of any siblings.

- **Standard deduction**. The new law increases the standard deduction to $24,000 for joint filers, $18,000 for heads of household, and $12,000 for singles and married taxpayers filing separately. Given these increases, many taxpayers will no longer be itemizing deductions. These figures will be indexed for inflation after 2018.

- **Exemptions**. The new law suspends the deduction for personal exemptions. Thus, starting in 2018, taxpayers can no longer claim personal or dependency exemptions. The rules for withholding income tax on wages will be adjusted to reflect this change, but IRS was given the discretion to leave the withholding unchanged for 2018.

- **New deduction for "qualified business income."** Starting in 2018, taxpayers are allowed a deduction equal to 20% of "qualified business income," otherwise known as "pass-through" income, i.e., income from partnerships, S corporations, LLCs, and sole proprietorships. The income must be from a trade or business within the United States. Investment income does not qualify, nor do amounts received from an S corporation as reasonable compensation or from a partnership as a guaranteed payment for services provided to the trade or business. The deduction is not used in computing adjusted gross income, just taxable income. For taxpayers with taxable income above $157,500 ($315,000 for joint filers), (1) a limitation based on W-2 wages paid by the business and depreciable tangible property used in the business is phased in, and (2) income from the following trades or businesses is phased out of qualified business income: health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners.

- **Child and family tax credit**. The new law increases the credit for qualifying children (i.e., children under 17) to $2,000 from $1,000, and increases to $1,400 the refundable portion of the credit. It also introduces a new (nonrefundable) $500 credit for a taxpayer's dependents who are not qualifying children. The adjusted gross income level at which the credits begin to be phased out has been increased to $200,000 ($400,000 for joint filers).

- **State and local taxes**. The itemized deduction for state and local income and property taxes is limited to a total of $10,000 starting in 2018. See Last Minute Saving Opportunities on page 3 for more on this.

- **Mortgage interest**. Under the new law, mortgage interest on loans used to acquire a principal residence and a second home is only deductible on debt up to $750,000 (down from $1 million), starting with loans taken out in 2018. And there is no longer any deduction for interest on home equity loans, regardless of when the debt was incurred.

- **Miscellaneous itemized deductions**. There is no longer a deduction for miscellaneous itemized deductions which were formerly deductible to the extent they exceeded 2 percent of adjusted gross income. This category included items such as tax preparation costs, investment expenses, union dues, and unreimbursed employee expenses.

- **Medical expenses**. Under the new law, for 2017 and 2018, medical expenses are deductible to the extent they exceed 7.5 percent of adjusted gross income for all taxpayers. Previously, the AGI "floor" was 10% for most taxpayers.

- **Casualty and theft losses.** The itemized deduction for casualty and theft losses has been suspended except for losses incurred in a federally declared disaster.

- **Overall limitation on itemized deductions**. The new law suspends the overall limitation on itemized deductions that formerly applied to taxpayers whose adjusted gross income exceeded specified thresholds. The itemized deductions of such taxpayers were reduced by 3% of the amount by which AGI exceeded the applicable threshold, but the reduction could not exceed 80% of the total itemized deductions, and certain items were exempt from the limitation.

- **Moving expenses**. The deduction for job-related moving expenses has been eliminated, except for certain military personnel. The exclusion for moving expense reimbursements has also been suspended.

- **Alimony**. For post-2018 divorce decrees and separation agreements, alimony will not be deductible by the paying spouse and will not be taxable to the receiving spouse.

- **Health care "individual mandate."** Starting in 2019, there is no longer a penalty for individuals who fail to obtain minimum essential health coverage.

- **Estate and gift tax exemption**. Effective for decedents dying, and gifts made, in 2018, the estate and gift tax exemption has been increased to roughly $11.2 million ($22.4 million for married couples).

- ***Alternative minimum tax (AMT) exemption***. The AMT has been retained for individuals by the new law but the exemption has been increased to $109,400 for joint filers ($54,700 for married taxpayers filing separately), and $70,300 for unmarried taxpayers. The exemption is phased out for taxpayers with alternative minimum taxable income over $1 million for joint filers, and over $500,000 for all others.

Last Minute Saving Opportunities

Disappearing or reduced deductions, larger standard deduction

- **State and local taxes** - Individuals (as opposed to businesses) will only be able to claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the total of (1) real estate taxes; and (2) state income taxes. Pay your 4th quarter Illinois estimated taxes by December 31st, if applicable (any other states too), rather than waiting until January 2018. For real estate tax prepayments, each Illinois county has specific rules. *Please see your county website for the rules* to prepay your 2018 real estate taxes. The last business day of the year is December 29th. But don't prepay your 2018 state income tax bill - Congress says such a prepayment won't be deductible in 2017. However, Congress only forbade prepayments for state income taxes, not property taxes, so a prepayment on or before Dec. 31, 2017, of a 2018 property tax installment is apparently OK.

- **Charitable contributions** –The itemized deduction for charitable contributions won't be chopped. But because most other itemized deductions will 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 because they won't be able to itemize deductions. If you think you will fall in this category, consider accelerating some charitable giving into 2017.

- **Mortgage interest deduction** – The interest on your existing mortgage is still deductible (the new law is for new loans) but the interest on home equity loans is no longer deductible in 2018. Make your January payments before the end of the year to boost your 2017 deductions.

- **Medical expenses** – The new law temporarily boosts itemized deductions for medical expenses. For 2017 and 2018 these expenses can be claimed as itemized deductions to the extent they exceed a floor equal to 7.5% of your adjusted gross income (AGI). Before the new law, the floor was 10% of AGI, except for 2017 it was 7.5% of AGI for age-65-or-older taxpayers. But keep in mind that next year many individuals will have to claim the standard deduction because many itemized deductions have been eliminated. If you won't be able to itemize deductions after this year, but will be able to do so this year, consider accelerating “discretionary” medical expenses into this year. For example, before the end of the year, get new glasses or contacts, or see if you can squeeze in expensive dental work such as an implant.

Other year-end strategies

Here are some other last-minute moves that can save tax dollars in view of the new tax law:

- **Alternative Minimum Tax** – The new law substantially increases the alternative minimum tax (AMT) exemption amount, beginning next year. There may be steps you can take now to take advantage of that increase. For example, the exercise of an incentive stock option (ISO) can result in AMT complications. So, if you hold any ISOs, it may be wise to postpone exercising them until next year. And, for various deductions, e.g., depreciation and the investment interest expense deduction, the deduction will be curtailed if you are subject to the AMT. If the higher 2018 AMT exemption means you won't be subject to the 2018 AMT, it may be worthwhile, via tax elections or postponed transactions, to push such deductions into 2018.

- **Like-kind Exchanges** – Like-kind exchanges are a popular way to avoid current tax on the appreciation of an asset, but after Dec. 31, 2017, such swaps will be possible only if they involve real estate that isn't held primarily for sale. <u>If you are considering a like-kind swap of other types of property (trading in vehicles for example), do so before year-end.</u> The new law says the old, far more liberal like-kind exchange rules will continue to apply to exchanges of personal property if you either dispose of the relinquished property or acquire the replacement property on or before Dec. 31, 2017.

- **Business Meals and Entertainment** – For decades, businesses have been able to deduct 50% of the cost of entertainment directly related to or associated with the active conduct of a business. For example, if you take a client to a nightclub after a business meeting, you can deduct 50% of the cost if strict substantiation requirements are met. But under the new law, for amounts paid or incurred after Dec. 31, 2017, there's no deduction for such expenses. <u>If you've been thinking of entertaining clients and business associates, do so before year-end</u>.

- **Moving Expenses** – The new law suspends the deduction for moving expenses after 2017 (except for certain members of the Armed Forces), and also suspends the tax-free reimbursement of employment-related moving expenses. So, if you're in the midst of a job-related move, try to incur your deductible moving expenses before year-end, or if the move is connected with a new job and you're getting reimbursed by your new employer, press for a reimbursement to be made to you before year-end.

- **Unreimbursed Business Expenses** – Under current law, various employee business expenses, e.g., employee home office expenses, are deductible as itemized deductions if those expenses plus certain other expenses exceed 2% of adjusted gross income. <u>The new law suspends the deduction for employee business expenses paid after 2017.</u> So, we should determine whether paying additional employee business expenses in 2017, that you would otherwise pay in 2018, would provide you with an additional 2017 tax benefit. Also, now would be a good time to talk to your employer about changing your compensation arrangement—for example, your employer reimbursing you for the types of employee business expenses that you have been paying yourself up to now, and lowering your salary by an amount that approximates those expenses. In most cases, such reimbursements would not be subject to tax.

- **529 Accounts** – Under the new law, for distributions after Dec. 31, 2017, "qualified higher education expenses" is expanded to include tuition at an elementary or secondary public, private, or religious school, up to a $10,000 limit per tax year. "Qualified higher education expenses" included tuition, fees, books, supplies, and required equipment, as well as reasonable room and board if the student was enrolled at least half-time. Eligible schools included colleges, universities, vocational schools, or other postsecondary schools eligible to participate in a student aid program of the Department of Education. This included nearly all accredited public, nonprofit, and proprietary (for-profit) postsecondary institutions. With the new withdrawal limit of $10,000 per year, you may want to consider funding elementary or secondary education.

The above covers some but not all aspects of the new law and possible tax savings opportunities.