December 27, 2017

2018 TAX LAW CHANGES

AT A GLANCE

This is a synopsis of the Tax Cuts and Jobs Act, which we hope will address concerns about the newly reformed tax code (signed into law on December 22, 2017) that will have an impact on our clients. Our goal is not to provide in depth analysis at this point however we offer this as a summary of the 500+ pages of relevant information to give our clients a sufficient breakdown of the new tax law changes. We are equally confident that this brief will increase awareness so that individuals and business entities may make informed choices during the coming tax year(s).

The new legislation brought major modifications, including additions and repeals to existing tax law. While some modifications have sunset provisions for taxable years 2018 through 2025, others do not. Essentially, the tax code's reform lowers tax rates on wages of individual incomes and corporate income taxes. The portion of the tax code's assertion is an to increase after-tax income for all taxpayers (this purports that after-tax incomes of all taxpayers would rise over time). By 2027, the top 1% of taxpayers will see incomes gains of greater than

4%; while taxpayers within the low to middle income groups will likely only see a rise of less than 1% gain.

All things considered, the new legislation simplifies the tax code (albeit some changes include sunset provisions) and expands the tax base to broaden economic enhancements for individuals and corporations. The new legislation also espouses economic enhancements that transitions the United States from a worldwide taxation policy to a territorial system of taxation that will also stimulate more growth in the U.S. economy.

Over the next ten years, we may see temporary increases in revenues to stimulate this growth by lowering corporate tax rates to 21% (which place more after-tax income in the hands of U.S. businesses to compete with foreign competitors) as well as lowering tax rates on individual wages, investments and business income.

By and large, after-tax incomes for all taxpayers will increase and the *temporary* revenue growth is explained by the numerous provisions set to expire. For example, the individual tax changes will expire on Dec 31, 2025 (unless repealed).

Below are highlights for individuals, businesses, estate and trusts and exempt organizations.

INDIVIDUALS:

Table 1 INDIVIDUALS

Tax Item Relates To	**Prior Law**	**Tax Cuts and Jobs Act (2018)**
Individual Tax Rates (the seven brackets are retained but the percentages on tax rates for ordinary income is lowered)	Brackets were: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%	Brackets **changed** to: 10%, 12%, 22%, 24% 32%, 35%, and 37%

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Standard Deduction	Joint: $12,700 Single: $6,350 H of H: $9,350	**Increased** Joint: $24,000 Single: $12,000 H of H: $18,000
Alternative Minimum Tax (AMT) Raised from $86,200 to $109,000 for married Filers & increases the phase out threshold to $1million	Individuals: 26,28%	Individuals still subject to AMT but available exemption increased
Personal exemptions	$4,050 available	Eliminated (Repealed)
Child Tax Credit	$1000 (phase out provision at $110k for married filing jointly)	$2000 (phase-out Provision at $400k for Married filing jointly)
State, Local including Property taxes (SALT) deductions	Deductible	Deductible with $10,000 max
Mortgage interest deduction	Limited to the interest on acquisition indebtness at $1M	Reduced $750K limit, and home equity debt deduction repealed
Net Capital gains and qualified dividends	Rates 0,15,20,23.8 %	No change
Net Investment Tax	Rate at 3.8%	No change
Additional Medi-care Tax	Rate at .09%	No change

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Affordable Care Act minimum essential coverage requirement	Subject to penalty if not covered	Penalty repealed starting in 2019

So, what does this do for taxpayers? Well, the plan has new tax rates placing more in the purse strings for all Americans however the personal exemptions, which previously had $4,050 available for taxpayers has been eliminated; along with miscellaneous deductions that were previously subject to exceeding two-percent of adjusted gross income. Although the plan retains the charitable contribution, increases of adjusted gross income for some taxpayers may present with a dilemma to donate respective to choosing between the standard deduction versus itemizing to make a charitable contribution. Also, a change in the medical expense deduction excess percentage is another change to note that will have direct effect on some individual tax return filings.

In 2017 and 2018, the change allows a deduction when medical expenses are in excess of 7.5 percent (so, the IRS really needs to update the 2017 Form 1040 because prior law had this at 10% for all taxpayers beginning January 1, 2017); otherwise this seems to be a nice tax benefit for medical deduction for now. In 2019, the medical deduction will revert back to allowable medical expenses in excess of 10% for all taxpayers. In short, some taxpayers will experience a lower tax burden while others may not see those benefits.

*Also, alimony payments deductions and inclusion in income is repealed.

The modifications made to 529 plans allow individuals to distribute up to $10,000 a year to these qualified plans to cover costs of public, private or religious elementary or secondary schools for distributions made after December 31, 2017.

Retirement planning tools proved to be valuable for many taxpayers in the past years. One change that the new tax law presents for some taxpayers is the limits on IRA contribution recharacterizations. The new law removes the ability to recharacterize conversions to a Roth IRA for 2018 and beyond. This repeals prior law however taxpayers may still recharacterize any

2017 Roth IRA conversion but the last day to do so is October 18, 2018. Speak with a financial advisor to determine which investment instrument is most beneficial for your portfolio.

Another change for 2018 that concerns real estate is section 1031 like-kind exchanges. The modification provides nonrecognition of gain limiting its application to real property that is not primarily held for sale and eliminates like-kind exchanges of personal property.

Regarding payroll withholdings, the IRS also announced on December 26, 2017 that they anticipate "issuing the initial withholding guidance in January reflecting the new legislation".

SALT deduction is a topic much talked about in the press. The new bill includes prohibitions on prepayment of 2018 state and local income taxes including property taxes. This does not mean that you can't make your fourth quarter tax payments this year in 2017 and take the deduction. You can and still deduct the payment on your 2017 tax return. In general, there are limitations to deducting prepaid taxes.

Still, state and local real property taxes may be deductible under certain circumstances. The Internal Revenue Service made the following announcement on December 27, 2017: "A prepayment of anticipated real property taxes that have not been assessed prior to 2018 are not deductible in 2017. State or local law determines whether and when a property tax is assessed, which is generally when the taxpayer becomes liable for the property tax imposed"

Please keep in mind, if you expect to be subject to AMT in 2017 it might not be beneficial to prepay state or property taxes by December 31, 2017 because you will not be able deduct them under AMT.

BUSINESS: Changes to Business Taxes

Table 2 BUSINESSES

Tax Item Relates To	**Prior Law**	**Tax Cuts and Jobs Act (2018)**
Corporate Rate	35% max	21% flat

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Pass-through income	Same as individual rates	20% deduction Code section 199A against pass-through income with certain limitations
AMT	Corporations:20%	Corporation AMT repealed
Section 179 expensing	$500K dollar limit	$1M dollar limit
Net operating Loss deduction	Limit to 90% of taxable income	Limit to 80% of taxable income
NOL Carryforwards	20 year carryforward	Indefinite carryforward

The major change in this category is the reduction of corporate (C Corporations) income tax rate from 35% to 21%. In addition, repeal of corporate AMT is also a major tax law change.

When it comes to passthrough businesses such as partnerships and corporations with S-election status and sole proprietors, a new section called Section 199A makes a deduction of 20% available. This deduction is taken against qualifying income before taxes.

There are changes in asset depreciation rules. Bonus depreciation percentage increased from 50% to 100% for property acquired and placed in service after September 27, 2017. The definition of qualified property also has been changed and now includes non-original use property.

Domestic production activities (DPA) under section 199 allowing a special deduction for domestic manufacturers is repealed.

Several other modifications exist involving partnership technical termination rules, provisions relating to accounting method changes, S corporation to C corporation conversions and NOL carryovers.

Corporate tax changes will require most taxpayers to reevaluate their existing entity choice and structure. While having an S corporation is still a viable option for many, complete planning and evaluation may lead to different choices.

The changes in the NOL carryover provisions are significant from both tax and financial statement presentation aspects.

ESTATE AND TRUSTS:

Table 3 ESTATE AND TRUSTS

Tax Item Relates To	Prior Law	Tax Cuts and Jobs Act (2018)
Trusts Tax Brackets	5 tax brackets Sample bracket: Over 12,500 39.6%	4 tax brackets Sample bracket: Over 12,500 37%
Estate and Gift Tax Basic Exclusion Amount in the case of decedents dying or gifts made after December 31, 2017	Inflation adjusted - $5.49 million in 2017	Estate, GST and gift tax exemption increased to $10 million

Estate, gift, and GST tax exemption amounts doubled to over $10 million for 2018 with amounts indexed for inflation annually but is set to expire after 2025. This means if no congressional action taken, amounts will revert to limits prior to 2018. As a side note, the new law had no effect on the annual gift tax exclusion however it has been adjusted for inflation and increased from $14,000 to $15,000 per donee for 2018.

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Even though the list is shorter in this category, changes will have major effects on trusts and individuals as income pass through to the individual beneficiaries. The reason for this is that trusts and estates are subject to similar income reporting and deduction rules as individuals. Trusts now have fewer deductions available and most miscellaneous deductions are repealed. While individuals now have increased standard deduction to offset some of these repealed deductions, a standard deduction is not available for trusts.

Trust administrators should consider evaluating to see if paying administrative expenses before December 31, 2017 will be beneficial for the trust. In addition, consideration should be made regarding distribution pay outs while keeping in mind that distributions may be eligible for the 65-day election to treat them towards 2017 even if they are made in 2018. This will give the administrator additional time to make the best decision.

The expansion of the standard deduction and estate tax exemption could have a significant impact on charitable giving. This is one of the reasons most charitable organizations are currently on the watch closely monitoring changes in giving and how it will impact their financial bottom line.

The impact of the new tax law will be more significant for large estates. Families with large closely held businesses do need a through estate planning so please contact a trust or estate attorney.

EXEMPT ORGANIZATIONS:

Table 4 EXEMPT ORGANIZATIONS

Tax Item Relates To	Prior Law	Tax Cuts and Jobs Act (2018)
Exempt organizations	Most provisions stay	Additions include: -UBTI calculations -NIT excise tax -Tax on excess compensation

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New changes are in addition to existing provisions when it comes to exempt organizations. Excessive executive compensation has always been an area largely scrutinized by the governing and taxing authorities, but new tax bill brings additional limitations in this area.

A new entity level tax will be in effect for the organization regarding amounts paid to certain executives in excess of $1M plus any excess parachute payments.

Computation of Unrelated Business Taxable Income is also updated by requirement that it to be computed separately for each unrelated trade or business.

Unrelated business taxable income is increased by amount of certain fringe benefits. Deduction for amounts paid in exchange for college athletic event seating rights is repealed as well as exclusion of gross income of interest on a bond issued to advance refund another bond.

New law brings a 1.4% excise tax on the investment income of certain private colleges and universities. There are specific definitions as to what institutions this provision will have an applicable effect on, which are all written out in the bill.

In summary, the bottom line effect of each tax law change largely depends on individual circumstances. Additionally, there are several areas in the new tax law where more clarification is required for the proper treatment of specific tax items. The U.S. Treasury Department will likely provide additional guidance, rulings, and temporary regulations where the law remains unclear and open to interpretation or additional guidance.

Please feel free to contact us at (858) 280 5388 for assistance or submit your question via email to info@hadriancpas.com.