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NEW TAX LAW CHANGES

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The Tax Cuts and Jobs Act (TCJA) was passed at the end of last year and has altered the tax landscape for many of individuals and businesses for tax years beginning in 2018. The changes are extensive, and this letter only provides a broad overview of some of the highlights to keep you informed. Many interpretations and regulations are still to be released by the IRS and additional tax changes have been proposed so the tax landscape is ever changing.

With this letter, WDR is hoping to provide a mid-year update and to review the changes announced early this year to keep you in the best tax situation. If you have any concerns with how the changes impact your tax situation or want to do any additional tax planning, we welcome you to give us a call any time.

Individual tax highlights

Changes in tax rates

You may have heard in the news that part of the goal of tax reform was to reduce the number of tax rates from the existing seven rates to three. While that was discussed, the bill that was signed into law still has seven rates, but they are now generally lower with the highest rate being reduced from 39.6% to 37%. The tax rates applicable to net capital gains and qualified dividends did not change.

Increased standard deduction

The new standard deductions are:

- Heads of household: $18,000
- Married filing jointly: $24,000
- All other taxpayers: $12,000

Although you may have historically had itemized deductions exceeding these amounts, other changes to itemized deductions may affect whether you are above the standard deduction in a given year. The increased standard deduction is effective through Dec. 31, 2025.

Wage withholding

While the tax rates decreased, the number of taxpayers having a balance due on their 2018 tax return is expected to go up because they are under withheld on their wages. The IRS has a withholding calculator at www.irs.gov/withholding that can be used to perform a quick “paycheck checkup”.

Elimination of personal and dependent exemptions

In the past, taxpayers received an exemption for themselves, their spouse and each of the eligible dependents that they claimed on their tax return ($4,050 each in 2017). The TCJA eliminated these exemptions through Dec. 31, 2025.

Child and family tax credit

The TCJA increased the child credit for children under age 17 to $2,000 and introduced a new $500 credit for a taxpayer’s dependents who are not their qualifying children. In addition, the phase-out limits for these credits have increased to $400,000 for joint filers ($200,000 for others), so that more individuals will be able to take advantage of this credit.

Changes to itemized deductions

- The overall phase out of itemized deductions has been repealed.
- The itemized deduction for state and local income and sales taxes is limited to a total of $10,000 ($5,000 for those using the filing status of married filing separately). For example, if you paid $15,000 in state income taxes and $6,000 in real estate taxes on your home ($21,000 in total), you would not be able to deduct the $11,000 that exceeds the deduction threshold since the tax deduction will be limited to $10,000.
- 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). Loans in existence on December 15, 2017 are grandfathered (balance up to $1 million still allowed).
- Interest on home equity indebtedness (such as a home equity line of credit) is no longer deductible **unless** the debt is acquisition indebtedness (used for home improvement or acquisition). Interest on debt used for vacations, credit card consolidation or buying a new car is no longer deductible. Interest on debt used for business or investment purposes may be deductible in a different category (not as an itemized deduction). Be sure to track the use of your debt and let us know so we can get the most out of your interest paid.
- Cash donations to public charities are now deductible up to 60% of adjusted gross income.

- Donations to colleges and universities for ticket or seat rights at sporting events are no longer deductible.
- Miscellaneous itemized deductions, such as investment management fees, tax preparation fees, unreimbursed employee business expenses and safe deposit box rental fees are no longer deductible. Taxpayers with unreimbursed employee expenses (mileage, home office, etc.) may be hit hard by this change. Consider discussing the possibility of reimbursement from your employer if you have unreimbursed work expenses.
- Medical expenses are deductible by the amount the expenses exceed 7.5% of adjusted gross income for 2018 (limit changes to 10% starting in 2019).

These changes (except as noted) to itemized deductions are in effect from Jan. 1, 2018 through Dec. 31, 2025.

Sec. 529 plans

Sec. 529 plans have been a widely used tool to help taxpayers save money for college, presuming they distribute that money for qualified higher-education costs. Certain Sec. 529 plans are eligible for a state tax deduction for contributions to the plan. The TCJA expanded the opportunities available for education tax planning by permitting $10,000 per year to be distributed from Sec. 529 plans to pay for private elementary and secondary tuition. While private elementary tuition is a qualified expense for federal distributions, New York State for example, does not consider this a qualified expense and distributions for private elementary tuition may be taxed by New York.

Alimony

Under the prior law, individuals who paid alimony to an ex-spouse received a deduction for the alimony paid, while the individuals receiving the alimony treated those payments as income. Tax reform has eliminated the deduction for alimony paid and the recognition of income for alimony received effective for divorce decrees executed after Dec. 31, 2018. We highly recommend that if you are amid divorce proceedings, please have a conversation with us and your divorce attorney to fully understand the financial impacts that this could have.

Estate and gift tax exemptions

Estate and gift tax laws have undergone several changes over the past decade. Under the TCJA, the estate and gift tax exemption has doubled to $11.2 million per person effective as of Jan. 1, 2018 and increases for inflation through 2025. On January 1, 2026, the exemption amounts are scheduled to revert to the 2017 levels adjusted for inflation. The state exemptions are different and often much lower than federal, such as the New York State exemption remaining at $5,250,000 through the end of 2018, with only inflation increases after that.

Individual shared responsibility payment

The TCJA repealed the individual shared responsibility payment for failure to have minimal essential healthcare coverage. However, this repeal does not take effect until Jan. 1, 2019. This means that if you did not have minimal essential healthcare coverage in the 2018 calendar year, you will still be subject to the penalty if you do not meet one of the exceptions from coverage.

State taxes become more complicated because of TCJA

The TCJA resulted in sweeping changes to federal taxes and resulted in a significant number of changes to many state tax returns. The higher federal standard deduction will result in some taxpayers no longer itemizing, although it may still be advantageous to itemize deductions on many state tax returns. Moving expenses were eliminated for federal but remain deductible for many states. Some higher taxed states are proposing "work around" deductions for the loss of the SALT (State and Local Tax) limitation on federal itemized deductions, although it remains to be seen whether IRS will challenge these alternative deductions.

Business tax highlights

New deduction for qualified business income

A new deduction, effective for tax years 2018 through 2025, was introduced in the TCJA that allows individuals a deduction of 20% of qualified business income from a partnership, S corporation or sole proprietorship, as well as 20% of qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership income.

This deduction will reduce taxable income, but not adjusted gross income, and is available regardless of whether you itemize your deductions. There are many limitations and restrictions to this provision and guidance is still forthcoming from the IRS to help interpret the most complicated new deduction under TCJA.

New corporate tax rate

The prior-law graduated corporate tax rates have been consolidated into one 21% flat rate. The separate rate for personal service corporations of 35% has been repealed. These changes are effective for tax years beginning after Dec. 31, 2017.

Entertainment expenses

The TCJA repealed the deduction for business entertainment. This includes expenditures such as taking clients to sporting events or shows and paying for season tickets for various entertainment events.

Meals

The deductibility of meals has changed in many cases under TCJA. Client meals where no business is conducted are not deductible. Client meals where business is conducted, documented, not extravagant or lavish and the taxpayer is present are 50% deductible. Business travel meals remain 50% deductible. Meals provided to employees, such as overtime meals, used to be 100% deductible and now are only 50%, while office holiday parties remain 100% deductible. Water, coffee and snacks at the office also went from 100% to only 50% deductible. It is very important to have your company's internal accounting set up appropriately to identify these expenses and treat them correctly on your tax return. Let us know if you need assistance.

Bonus depreciation and Sec. 179 expensing of fixed assets

Over the past decade, bonus depreciation and Sec. 179 expensing have been popular tax planning tools. While the rate of bonus depreciation and the amount of the maximum Sec. 179 limit have varied, the ability to deduct significant portions (or the entirety) of fixed asset purchases has been appreciated by business owners. The new tax reform bill has increased the bonus depreciation percentage to 100% until 2023, where it will decrease by 20% until it reaches zero. Bonus depreciation is now available for both used and new qualified assets. The Sec. 179 expense limit is now $1 million of allowable expensing with a total purchase threshold of $2.5 million. If you purchase more than $2.5 million in eligible fixed assets during the year, you will see a reduction in the amount you can expense under Sec. 179.

These amounts are much higher than they have historically been and, in many cases, well beyond what an average business owner will spend in a given year. However, these higher limits and the availability of bonus depreciation and Sec. 179 allows for some excellent tax planning opportunities.

Interest expense deductibility

A change in how interest expense is deducted on corporate returns got a lot of airtime in the media, however, it may have no impact on how you have done business for years. The revised provision creates a limitation for businesses whose annual average gross receipts are more than $25 million. If your company falls below that number, do not expect any changes. If your gross revenue exceeds $25 million, let's have a conversation about how interest expense will be calculated for your business and its impact.

Like-kind exchange restrictions (Trade In)

The new tax law restricts a trade in or like-kind exchange to real property (e.g., buildings and land). Under the prior law, you could trade in a business vehicle or equipment for similar property and defer the gain, but no longer. Be aware of this change especially when you are trading older business vehicles and equipment which could result in tax now while in prior years it didn't.

Credit for paid family and medical leave

A new credit was created under the TCJA for employers who provide eligible employees paid family and medical leave. You may be providing paid leave for employees already, although we may need to ensure that the employee benefit qualifies for the new credit. There may be minor adjustments necessary to make your leave policy compliant with the new credit.

Net operating losses (NOLs)

Under the prior tax law, we had the flexibility of carrying a net operating loss (NOL) back two years or carrying it forward for 20 years. Unfortunately, the TCJA repealed the ability to carry back a NOL and claim a refund for already-paid taxes, effective for tax years starting after Dec. 31, 2017. If you have a tax situation that resulted in a NOL, we can advise you of the best options.

Planning ahead

While the TCJA is effective now, there are still many uncertainties. The new form 1040 individual tax form has been successfully reduced to the size of postcard, although the taxes have been complicated with many new schedules and many more differences between the federal and state returns.

We are at your disposal to identify opportunities within the new law that apply to you and help steer you away from new pitfalls and challenges. Please feel free to call our office at 518-792-0918 if you would like to set up a tax planning meeting.

Sincerely,

WDR
CPAs & Business Advisors

WHITTEMORE, DOWEN
& RICCIARDELLI, LLP