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Best Client Ever
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Dear Valued Client,

Happy 2018! With the ringing of the New Year, we at RidoutBarrett are off to the races analyzing the new tax laws brought to us by the current administration. The new tax changes will affect you starting in 2018 for taxes due in 2019. This correspondence is an overview of the changes we believe will affect you the most. Included are changes in all areas of the law. Not all sections will apply to you individually or your business. We will use these changes to estimate your 2018 taxable income and corresponding tax liability. This is not an exhaustive list of changes, but simply an overview. The information is organized within the following sections: 1) General Business Changes, 2) Pass-Through Entities Tax Changes, 3) C-Corporation Tax Changes, 4) Individual Tax Changes, and 5) Estate and Trust Income Tax Changes. This information is technical and not intended to overwhelm you. We simply want to provide you with an overview of the various changes in the new tax law.

The official name of the act is: An Act to Provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.

The informal and the name you will most often hear is “Tax Cuts & Jobs Act”.

1. **General Business Changes**

Increased Section 179 Expense. For tax years beginning after December 31, 2017, taxpayers may expense up to $1 million under Section 179, and the phase out threshold amount is increased to $2.5 million. These amounts will be indexed for inflation in tax years beginning after 2018.

100% Bonus Depreciation. For qualified property placed in service between September 27, 2017 and January 1, 2023, taxpayers are allowed a 100% bonus depreciation deduction.

Luxury Automobile Depreciation Limits Increased. For tax years beginning after December 31, 2017, the maximum depreciation amount for luxury automobiles is increased to $10,000 for the year placed in service, $16,000 for the second year, $9,600 for the third year and $5,760 for the fourth year onwards in the recovery period. These amounts will be indexed for inflation in tax years beginning after 2018.

Net Operating Loss (NOL) carryover. For NOLs arising in tax years ending after December 31, 2017, the two-year carryback and the special carryback provisions are repealed. However, a two-year carryback remains in effect for certain losses incurred in the trade or business of farming.

Like-Kind Exchange Treatment Limited. For tax years beginning after December 31, 2017, the gain deferral for like-kind exchanges applies only to real property not held primarily for sale. Personal property will no longer qualify for like-kind exchange gain deferral.

Cash Method of Accounting. For tax years beginning after December 31, 2017, taxpayers with average gross receipts not exceeding $25 million are allowed to use the cash method of accounting.

Entertainment. For tax years beginning after December 31, 2017, taxpayers will not be able to deduct entertainment expenses.

Accounting for Long-Term Contracts. For contracts entered into after December 31, 2017, the exception for small construction contracts from the requirement to use the percentage of completion method is expanded to apply to contracts for the construction or improvement of real property if the contract:

- Is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract, and
- Is performed by a taxpayer that (for the tax year in which the contract was entered into) meets the $25 million gross receipts test.

2. Pass-Through Entities Tax Changes

Qualified business income deduction. Under the new law, beginning in 2018, pass-through entities may qualify for a deduction up to 20% of qualified domestic business income subject to certain limitations based on taxable income. The limitations are phased in for taxpayers with taxable income of $315,000 married filing jointly ("MFJ") and $157,000 for all other filers. Qualified business income ("QBI") is defined in section 199A(c) as ordinary income less ordinary deductions from a qualified trade or business. Qualified business income does not include capital gains and losses, dividend, or interest income. Any potential deduction is taken at the taxpayer level.

Specified Service Trades or Business. Businesses that are classified as "Specified Service Trades or Business" are not allowed to take the Qualified Business Income deduction unless the taxpayer's taxable income is less than $315,000 (MFJ) or $157,000 for all other filers, subject to the phase in thresholds of $100,000 (MFJ) and $50,000 for all other filers. Specified Service Trades or Business are businesses involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.
The calculation of deduction for taxpayers above the taxable income threshold is as follows:

- 20% of the taxpayer's "qualified business income" limited by the **greater of:**
  - 50% of allocable W-2 wages with respect to the business, **or**
  - 25% of the allocable W-2 wages with respect to the business plus 2.5% of the allocable share of the unadjusted basis of all qualified property.

EXAMPLE 1
Individual taxpayers with taxable income less than $315,000(MFJ) $157,000 for all other filers will calculate the deduction as follows:

Qualified business income =$150,000
Allocable W-2 wages from the trade or business = $40,000
Taxable income for a married filing joint return = $290,000

Because the client's taxable income is less than the $315,000, the calculation is 20% of the qualified business income ($150,000 x 20% = $30,000). The W-2 limitations do not apply for taxpayers with taxable income under the thresholds.

EXAMPLE 2

If the client's taxable income is over the phase in limits of $415,000(MFJ) and $207,000 for all other filers, the taxpayer is limited to the lessor of the 20% QBI or the W-2 wage limitations.

Pro-rata share of qualified business income =$150,000
Allocable W-2 wages from the trade or business = $40,000
Taxable income for a married filing joint return = $500,000
Pro-rata share of unadjusted basis in the business property = 0

The client's deduction is now calculated as follows:

- 20% of the taxpayer's "qualified business income" = $150,000 x 20% = $30,000 **limited by the greater of:**
  - 50% of the W-2 wages with respect to the business = $20,000, **or**
  - 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property = $10,000 + 0 = $10,000

The client deduction is now limited to $20,000 which is the lessor of the two limitations.

3. C-Corporation Tax Changes

Rate changes for C Corporations. For tax years beginning after December 31, 2017, C-Corporations will pay a flat 21% tax rate. Dividends from a C-Corporation will still be taxed at 20%. Double taxation still exists for C-Corporations.

Example of Double Taxation:

Taxable Income:	$5,000,000
Tax Rate:	21%
Tax on Income:	$1,050,000
Corporation's Amount Available for Dividend (After Tax):	$3,950,000
Dividend to Shareholders:	$3,950,000
Shareholders' Tax Rate on Dividend:	20%
Shareholders' Tax on Dividend:	$790,000
Amount Received After Tax:	$3,160,000
Effective Tax Rate:	37%

NOTICE: Because of the double-taxation of C-Corporations, the effective tax rate is the top marginal rate for individual income tax.

Alternative Minimum Tax (AMT) for C-Corporations Repealed. For tax years beginning after December 31, 2017, the corporate AMT is repealed.

4. <u>Individual Income Tax Changes</u>

Rate changes for individuals. Individuals are subject to income tax on ordinary income (ex. compensation, retirement and interest income) at graduated tax rates applicable to their respective tax bracket and filing status.

New rates. Beginning with the 2018 tax year and continuing through 2025, there will be seven tax brackets for individuals.

Single Tax Bracket

New Rate	New Income Bracket	Old Rate	Old Income Bracket
10%	Up to $9,525	10%	Up to $9,525
12%	$9,525 - $38,700	15%	$9,525 - $38,700
22%	$38,700 - $82,500	25%	$38,700 - $93,700
24%	$82,500 - $157,500	28%	$93,700 - $195,450
32%	$157,500 - $200,000	33%	$195,450 - $424,950
35%	$200,000 - $500,000	35%	$424,950 - $426,700
37%	$500,000+	39.6%	$426,700+

Married Filing Jointly Tax Bracket

New Rate	New Income Bracket	Old Rate	Old Income Bracket
10%	Up to $19,050	10%	Up to $19,050
12%	$19,050 - $77,400	15%	$19,050 - $77,400
22%	$77,400 - $165,000	25%	$77,400 - $156,150
24%	$165,000 - $315,000	28%	$156,150 - $237,950
32%	$315,000 - $400,000	33%	$237,950 - $424,950
35%	$400,000 - $600,000	35%	$424,950 - $480,050
37%	$600,000+	39.6%	$480,050+

Married Filing Separately

New Rate	New Income Bracket	Old Rate	Old Income Bracket
10%	Up to $9,525	10%	Up to $9,525
12%	$9,525 - $38,700	15%	$9,525 - $38,700
22%	$38,700 - $82,500	25%	$38,700 - $78.075
24%	$82,500 - $157,500	28%	$78,075 - $118,975
32%	$157,500 - $200,000	33%	$118.975 - $212,475
35%	$200,000 - $300,000	35%	$212,475 - $240,025
37%	$300,000+	39.6%	$240,025+

Head of Household

New Rate	New Income Bracket	Old Rate	Old Income Bracket
10%	Up to $13,600	10%	Up to $13,600
12%	$13,600 - $51,800	15%	$13,600 -$51,850
22%	$51,800 - $82,500	25%	$51,850 - $133,850
24%	$82,500 - $157,500	28%	$133,850 - $216,700
32%	$157,500 - $200,000	33%	$216,700 - $424,950
35%	$200,000 - $500,000	35%	$424,950 - $453,350
37%	$500,000+	39.6%	$453,350+

New limitations on "excess business loss". For tax years beginning after December 31, 2017, and before January 1, 2026, excess farm loss limitation do not apply. Instead, a non-corporate taxpayer's "excess business loss" for a tax year is disallowed, and the disallowed loss is carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in later tax years. This limitation applies after the application of the passive loss rules.

Net Operating Loss carryover. For NOLs arising in tax years ending after December 31, 2017, the two-year carryback and the special carryback provisions are repealed. However, the two-year carryback still applies in the case of certain losses incurred in the trade or business of farming.

Limit on state and local tax deduction. For tax years 2018 through 2025, the Act limits the aggregate deduction for real and personal property taxes; general sales taxes (if elected); state, local, foreign income, war profits, and excess profits taxes for any tax year to $10,000 ($5,000 for married filing separately). *Important exception:* The limit doesn't apply to: (i) foreign income, war profits, and excess profits taxes; (ii) state, local, foreign, real and personal property taxes if those taxes are paid or accrued in carrying on a trade or business or in an activity engaged in for the production of income.

Changes in the rules for deducting qualified residential interest. Under the Act, starting in 2018, the limit on qualifying acquisition debt is reduced to $750,000 ($375,000 for a married taxpayer filing separately). Starting in 2018, the deduction for interest on home equity debt is disallowed. This applies regardless of when the home equity debt was incurred.

Changes in alimony treatment. Under the new Act, the prior-law above-the-line deduction for alimony payments is repealed. The prior-law requirement that the person receiving alimony payments include the alimony payments into income is repealed. These changes are permanent.

New rules do not apply to divorces and separations in effect prior to the Act, as well as divorces and separations that are executed *before 2019*.

Existing divorce and separation decrees that are legally modified are not required to apply the new rules of the Act, unless the modification *expressly provides* that the Act rules are to apply.

Moving expenses deduction suspended. For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for moving expenses is suspended, except for members of the Armed Forces who are on active duty, who move pursuant to a military order, and who are incident to a permanent change of station.

Standard deduction increased. For tax years beginning after December 31, 2017 and before January 1, 2026, the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers. These amounts are adjusted for inflation in tax years beginning after 2018. No changes are made to the current-law additional standard deduction for the elderly and blind.

Personal exemptions suspended. For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for personal exemptions is effectively suspended because the statutory exemption amount is reduced to zero.

Child tax credit increased; partial credit for non-child dependents. For tax years beginning after December 31, 2017 and before January 1, 2026, the child tax credit is increased to $2,000 phasing out at income levels of $400,000 for married taxpayers filing jointly ($200,000 for all other taxpayers). The amount of the credit that is refundable is increased to $1,400 per qualifying child, and this amount is indexed for inflation up to the base $2,000 base credit amount. The earned income threshold for the refundable portion of the credit is decreased from $3,000 to $2,500. No credit will be allowed to a taxpayer with respect to any qualifying child unless the taxpayer provides the child's social security number. In addition, a $500 nonrefundable credit is provided for certain non-child dependents.

Medical expense deduction threshold temporarily reduced. For tax years beginning after December 31, 2016 and ending before January 1, 2019, the threshold for medical expense deductions is reduced to 7.5% of adjusted gross income (AGI) for all taxpayers.

Miscellaneous itemized deductions suspended. For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for miscellaneous itemized deductions that are subject to the 2%-of-AGI floor is suspended. This includes the deduction for employee business expenses and tax preparation services.

529 Savings Plans. Currently, funds in 529 Saving Plans can be withdrawn tax-free if used for higher education expenses. The Act allows up to $10,000 per year used for elementary and high school tuition, and allows funds to be used for private and religious schools.

Individual AMT retained, with higher AMT exemption amounts. For tax years beginning after December 31, 2017 and before January 1, 2026, the Act increases the amount of an individual's alternative minimum taxable income (AMTI) that is exempt from AMT. The AMT exemption amounts are as follows:

- For joint returns and surviving spouses, $109,400;
- For single taxpayers, $70,300;
- For married filing separately, $54,700.

Repeal of ACA individual mandate. Under pre-Act law, the Affordable Care Act (ACA) required individuals to pay a "shared responsibility payment" (also referred to as a penalty) with their federal tax return, for any month the individual did not have minimum essential coverage. The Act permanently repeals the individual shared responsibility payment for tax years after December 31, 2018.

5. ***Estate and Trust Income Tax Changes***

Electing Small Business Trusts

- ***Beneficiaries.*** Stock in an S-Corporation may be held by an "Electing Small Business Trust." The beneficiaries of the trust are, in effect, the shareholders of the corporation. The definition of a qualifying beneficiary has been expanded to include non-resident aliens.
- ***Taxation.*** The ESBT pays tax at the trust level on 100% of the S-Corporation income regardless of whether or not any of the income was distributed. The income is taxed at the highest tax rate imposed on an individual taxpayer.
- ***Charitable Contributions.*** Limitations on charitable contributions will be imposed and effective for tax years beginning after December 31, 2017. The limitations are the same as individual limitations. Excess contributions are carried forward for up to 5 years.

Estate Tax Exemption. The estate tax exemption doubled from $5.6 million to $11.2 million and expires on December 31, 2025. The exemption will increase with inflation.

We hope this information provided insight on the new tax changes. We will be working with you to determine any possible planning steps you should consider. Please do not hesitate to contact us with any questions you have. This information can also be found on our website: www.RidoutBarrett.com.

Sincerely,

Ridout Barrett, & Co. P.C.
CPAs & Business Consultants