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November 2018

Dear Tax Client:

Big changes have gone into effect in 2018 resulting from the massive new tax legislation enacted last year. The Tax Cuts and Jobs Act of 2017 was signed into law in December 2017 and provided a major overhaul to the previous tax legislation. This letter is designed to give a high-level overview of the major provisions of the new law and how it will impact your 2018 tax return.

INDIVIDUAL TAXES

- The standard deductions nearly double to $24,000 for couples; $12,000 for singles and $18,000 for household heads. Those age 65 or up and blind people get $1,300 more per person ($1,600 if unmarried). Given these much higher amounts, it's a sure bet that far fewer people will itemize.

- The law keeps seven tax brackets, but with different rates and break points. For example, not only is the top individual rate lowered from 39.6% to 37%, but that rate kicks in at a higher income level. Note that whatever new bracket you fall into, more of your taxable income will be hit with lower rates than before.

- Personal exemptions for individual filers and their dependents have been repealed.

- The child tax credit is doubled to $2,000 for each dependent under age 17. The income phase-out thresholds are much higher – AGI over $400,000 for joint and $200,000 for all other filers.

- There's a new $500 credit for each dependent who is not a qualifying child.

- Home mortgage interest can be deducted on up to $750,000 of new acquisition debt on a primary and secondary residence (down from $1 million). Older loans and refinancings up to the old loan amount get the $1 million cap. However, no write-off is allowed after 2017 for interest on existing or new home equity loans from which the proceeds are used to buy a car, pay down credit card debt and the like.

- The popular deduction for state and local taxes is being squeezed. You can deduct any combination of residential property taxes and income or sales taxes up to a $10,000 cap. Property taxes remain fully deductible for taxpayers in a business or for-profit activity, so taxes paid on rental realty can be taken in full on Schedule E.

- **The following write-offs are eliminated:**
  - Deductions for job-related moves, except for the military.
  - All miscellaneous write-offs subject to the 2%-of-AGI threshold, including employee business expenses, brokerage and IRA fees, hobby expenses and tax return preparation costs.
  - Theft losses.
  - Personal casualty losses, excluding those in presidentially declare disaster areas.
  - Alimony for post-2018 divorce decrees; although it's good news to recipients who will not be taxed on the alimony they receive. Existing divorces and separations are not affected.

- The medical expense deduction remains for 2018, allowing a deduction for such expenses in excess of 7.5% of AGI.

- The charitable contribution write-off remains for 2018. The AGI limitation on cash donations to qualified charities is hiked from 50% to 60%.

- The write-off for personal gambling losses to the extent of winnings survives for 2018.

- Upper-income individuals can finally say good-bye to a sneaky tax hike: the phase-out of itemized deductions is scrapped under the new law.

- Tax rates on long-term capital gains and qualified dividends do not change. The 0% rate will continue to apply for taxable income under $38,600 (single) and $77,200 (joint). The 20% rate starts at $425,800 (single) and $479,000 (joint). The 15% rate applies for incomes between those break points. The 3.8% surtax on net investment income remains, kicking in for modified AGI over $200,000 (single) and $250,000 (joint).

- Obamacare's individual mandate is on the way out. The requirement to have health insurance, qualify for an exemption, or pay a fine is repealed for 2019 forward. However, the mandate continues to apply for 2018.

- 529 college savings plans are enhanced to allow annual distributions of up to $10,000 per student to pay tuition for elementary and secondary education. Note that the $10,000 cap does not apply to 529 plan withdrawals to pay for college.

BUSINESS TAXES

- Regular corporations ("C-corporations") **will pay tax at a flat 21% rate**, down from the 35% top rate now. This lower rate begins in 2018 and is permanent.

- Many individual owners of pass-throughs **will get a new 20% deduction**. The rules cover sole proprietors and owners of S-corporations, partnerships, and LLCs. They can generally deduct 20% of qualified business income. However, limits apply to individuals with taxable income in excess of $315,000 (joint) and $157,500 (all others):
    - The deduction phases out for these high-income taxpayers in certain service fields such as health, law, accounting, financial services, performing arts, consulting, or any business where the principal asset is the reputation or skill of its employees.
    - There is a W-2 wages-paid limitation for high-income individuals that applies even if the person isn't engaged in the previously noted service businesses.

- The write-off for business losses on individual returns is capped. The amount of trade or business losses that exceed a $500,000 threshold for couples and $250,000 for other filers is nondeductible, but any excess can be carried forward.

- Regarding asset purchases: 100% bonus depreciation is available for many assets put into use during the year. The break applies to assets put in service after September 27, 2017, and is temporary – generally lasting until 2022 and then phasing out 20% each year thereafter.

- The cap on expensing business assets doubles to $1 million. More property is eligible for first-year bonus depreciation or expensing. Depreciation limitations on passenger automobiles are increased.

- For firms with over $25 million in gross receipts, the deduction for interest on business debt is limited. It will be capped at 30% of adjusted taxable income, with disallowed interest carried forward.

- Firms that provide paid family or medical leave to workers get a new credit generally equal to 12.5% of the amount of wages paid during the period of leave. The credit is temporary – applying only for 2018 and 2019.

- Many business breaks are eliminated or scaled back including:
    - Business entertainment
    - Country club dues
    - The 9% domestic production deduction
    - Net operating losses can offset only 80% of taxable income, and NOL carrybacks are generally prohibited
    - Tax-deferred like-kind exchanges are limited to real property not held primarily for sale
    - Meals in on-premises dining facilities are limited to 50% through 2025, then fully eliminated in later years
    - The write-off employers take for the cost of transportation-related fringe benefits for their workers including on-site parking and mass transit passes is disallowed

This letter presents a very general overview of the changes coming our way, but hopefully provides some helpful information in your year-end tax considerations. We at Kotzan CPA & Associates wish you and yours a healthy and safe holiday season. We appreciate the opportunity to serve your tax and accounting needs, and look forward to seeing you soon!

Sincerely,

Kotzan CPA & Associates, P.C.