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FOR IMMEDIATE ATTENTION: THE NEW TAX LAW: WILL IT HELP YOU OR HURT YOU?

WHAT'S NEW FOR 2018 AND HOW TO PLAN FOR YEAR-END

On December 22, 2017 the "Tax Cuts and Jobs Act" of 2017 was signed into law. The new law changes many *fundamental aspects* of the tax law as we knew it. We know these tax changes may have you feeling concerned, worried, perhaps frightened; **or** perhaps optimistic. It's difficult to make sense as to how these changes **affect you**. Rest assured that we at Family Tax Advantage, are well-versed in the new law, and want to work with you to answer all of your questions and concerns, and ease your mind.

This Newsletter details the major changes for 2018 and beyond. Some changes won't affect you at all; other changes will. We are ready to help you navigate these new waters. It is important that you feel comfortable reaching out to us. Call or write anytime.

Most of the changes take effect in 2018, but a few are effective in 2017 or 2019. The changes to corporate taxes are permanent, whereas most changes to individual taxes expire at the end of 2025, after which most individual's tax rules will revert to 2017 law. As of this writing, Congress is considering making the changes for individuals permanent.

What's in the New Law

The primary effect of new law is to drastically reduce taxes on large corporations (from 35% to 21%), give special tax breaks to certain small and large businesses, and significantly reduce taxes on high-income individuals. In our experience in planning for 2018, *most of our individual clients are only mildly affected by the new law. However, some of you will see significant changes, either up or down, in your 2018 taxes*. Since most of our clients are individuals and small businesses we will focus on those provisions. We have summarized most of the changes in a table at the end of this Newsletter. All reference to forms and line numbers are to 2017 Form 1040 and its schedules. You can look at your individual numbers as you read this. **State income tax** rules may or may not follow some or all of these Federal changes.

INDIVIDUALS

Many items change for 2018 due to the usual annual inflation adjustments which are shown in the table at the end of this Newsletter. Beginning in 2019, annual changes will be calculated differently, resulting in smaller adjustments in nearly all areas of the tax law, including Social Security. This is a long-term *tax increase* for everyone.

Who Should or Must File a 2018 Tax Return

You **MUST FILE** 2018 Federal and State returns if:

- Your **Adjusted Gross Income** (Form 1040, Line 37) is greater than the Standard Deduction (see below for your Standard Deduction); OR
- You have any of the following in your Federal return:
  - Schedule C: Income from business, profession, self-employment, independent contractor.
  - Schedule D: Capital gains, capital losses, capital loss carryforwards.
  - Schedule E: Income from rents, royalties, partnerships, S-corporations, trusts, estates.
  - Schedule F: Income from Farming.
  - You received a Federal subsidy to pay your Obamacare premiums, or wish to claim a credit to offset the premium cost, or claim an exemption from the Obamacare healthcare mandate.

You **SHOULD FILE** 2018 Federal and State returns if:

- You have had Federal or State income **taxes withheld** from your salary or wages; or distributions from pension plans, IRAs, 401(k)'s, annuities, Social Security, and other retirement income; or interest or dividend income; OR
- You paid 2018 Federal or State **estimated taxes** or had all or part of your **2017 refund applied** to 2018 taxes; OR
- You are eligible for a **refundable credit** including the Earned Income Credit (for low-income wage earners), Child Tax Credit (for people with children under age 17), and other credits on Form 1040, Lines 66-69.

New Tax Rates and Brackets:

2017 Joint (Old Law)				
Taxable Income				
At least	But not more than	The tax is:	Plus this %	Of the amount that exceeds:
$0	$18,650	$0	10%	$0
18,650	75,900	1,865.00	15%	18,650
75,900	153,100	10,452.50	25%	75,900
153,100	233,350	29,752.50	28%	153,100
233,350	416,700	52,222.50	33%	233,350
416,700	470,700	112,728.00	35%	416,700
470,700		131,628.00	39.6%	470,700

2018 Joint (New Law)				
Taxable Income				
At least	But not more than	The tax is:	Plus this %	Of the amount that exceeds:
$0	$19,050	$0	10%	$0
19,050	77,400	1,905	12%	19,050
77,400	165,000	8,907	22%	77,400
165,000	315,000	28,179	24%	165,000
315,000	400,000	64,179	32%	315,000
400,000	600,000	91,379	35%	400,000
600,000		161,379	37%	600,000

Upon request, we'll be glad to send you the tables for Single, Head-of-House, or Married/Separate.

Capital Gains rates and the rates for **Qualified Dividends** remain at 0%, 15%, or 20% depending upon taxable income:

2018 Capital Gains Rates (Joint)		
Taxable Income		
At Least	But not more than	Tax Rate
$0	$77,400	0%
$77,400	$480,050	15%
$480,050		20%

Personal Exemptions for yourself, spouse, and dependents are repealed in 2018. You will no longer get a deduction of $4,150 per person on your 2018 tax return. This might be somewhat offset by the increased Standard Deduction.

The Standard Deduction increases as follows:

	2017	New Law 2018
Married filing jointly	$12,700	$24,000
Single or Married/Separate	$ 6,350	$12,000
Head of Household	$ 9,350	$18,000

You get an **additional Standard Deduction** of $1300 *per spouse* if either of you are blind (vision is 20/200 or worse in the better eye with glasses) and/or over age 65 (born on or before 1/1/1954). If you are not married, your additional standard deduction is $1,600 for blind and $1600 for being over 65. These are added to the table amounts above. Therefore, a married couple, both over 65, get a standard deduction of $24,000 + $1,300 + $1,300 = $26,600. *The increase in the Standard Deduction will mean that many people will no longer itemize their deductions.*

Planning: If you have and IRA, 401(k), or other retirement plan that has a **Required Minimum Distribution** ("RMD"), you can satisfy the RMD by making donations to charity directly from your retirement account. You can give cash (by check or electronic transfer) or securities (by electronic transfer). The gift must go directly to the charity, and never go through your own hands. The transfer is not income to you nor deductible by you. The effect is to get your RMD tax-free.

Planning: Making charitable contributions from a retirement account (even if you do not have an RMD) is beneficial if you do not itemize your deductions. Doing this means you will never pay tax on the amount donated, so it has the same tax effect as if you got a deduction for the gift.

Planning: If you have large charitable contributions and/or medical expenses, try to bunch them in one year. For example, if you normally give $1000 per year to a charity, make your 2019 donation in 2018. If you owe or expect to owe medical bills, get them all paid in 2018 even if that means paying in advance. (Payment by credit card counts *in the year the card is charged*, regardless of when paid.) If the numbers are large enough, you might get

enough itemized deductions to get above the standard deduction. Also, medical deductions are subject to greater restrictions in 2019 than 2018 (see next page).

Itemized Deductions

Medical Expenses have been deductible to the extent the total exceeded 10% of Adjusted Gross Income (Form 1040, Line 37), or 7.5% for people over 65. The New Law changed the percentage back to 7.5% for everyone, but only in 2017 and 2018. In 2019 it becomes 10% for everyone.

Deduction for **State And Local Taxes** (often referred to as "SALT") has been limited starting in 2018. The **total amount** of state and local income taxes, sales taxes, real estate taxes, and personal property taxes that may be deducted **is $10,000**, except for foreign real estate taxes which cannot be deducted at all. This will be particularly hurtful in states that have high state income taxes and/or real estate taxes. The ten states with the highest overall tax burden as a percentage of average income are: NY, HI, ME, VT, MN, CT, RI, IL, NJ, CA. However, property taxes and sales taxes incurred in a business or income-producing activity are allowed as a deduction. If you are self-employed, call or write to us to discuss this.

Some states have passed laws to try to get around the state and local tax limitation, but the IRS has ruled that these new state laws are not valid. People in states (such as **Arizona**) that already give state tax credits for charitable contributions, will lose their Federal deductions for these donations.

Deduction for **Mortgage Interest:** Under the old law you could deduct the interest on a maximum of $1,000,000 of mortgage debt, plus on a maximum of $100,000 of a home equity line of credit. For mortgages initiated on or after December 15, 2017, the limit is the interest on $750,000 of debt. The interest on **Home Equity Lines of Credit** ("HELOC") is *not deductible* starting in 2018 except for portions of the loan used directly to purchase or physically improve the property. It's important that you keep accurate records of borrowing against a HELOC to trace the funds to their use.

December 15, 2017 is the critical date for mortgages. Mortgages in effect before this date remain at the $1,000,000 limit of the old law, including re-financing these mortgages for no more than the old mortgage's outstanding balance. Mortgages committed on or after 12/15/17 must have closed by March 31, 2018 to be subject to the old rules.

Deductions Repealed as of 2018: All so-called "Job Expenses and Certain Miscellaneous Itemized Deductions" (Lines 21 to 27 of the 2017 Schedule A and Form 2106) are repealed. The ones marked with a (★) will hurt some people a great deal.

- (★) Employee business expenses such as *unreimbursed* use of personal vehicle, travel, hotels, home office, meals, entertainment, and more.
- Fees for tax preparation and advice.
- (★) Disaster losses such as theft, fraud, fire, storm damage, etc. except in areas designated by the President as Federal Disaster Areas.
- (★) Investment management, advisory, and custodial fees.
- Safe deposit box rentals.
- Union & professional dues
- Job search costs
- IRA fees paid from your own funds. (IRA fees paid from the IRA were never deductible.)
- And many others

The **overall limitation on itemized deductions** for high-income individuals is repealed.

Other Deductions:

(★) **Moving Expenses** (Form 3903 and Form 1040, Line 26) for job-related moves is **repealed in 2018**.

Alimony: For divorces or separation agreements **executed in 2019 or later**, alimony received is *not income* and alimony paid is *not deductible*. For divorces and separation agreements in effect on or before 12/31/18, the old rules apply.

Other Taxes and Credits:

The **Alternative Minimum Tax Exemption** amounts are increased thereby **eliminating this tax** for most middle-income taxpayers. Starting in 2019 the exemption amounts will be indexed for inflation.

	2017	New Law 2018
Married filing jointly	$84,500	$109,400
Married/Separate	$ 42,500	$ 54,700
Single or Head of Household	$ 54,300	$ 70,300

The **Child Tax Credit** (Form 1040, Line 52) is increased from $1,000 to $2,000 per qualifying child. Also new is a $500 credit for each dependent who is *not a child*, such as a parent. Up to $1,400 per child can be a **"refundable"** credit (Form 1040, Line 67). A "refundable" credit is treated as if it were a pre-payment of tax (such as withholding tax or estimated tax), and can therefore be refunded even if it exceeds your tax. Child tax credits begin to phase-out when taxable income exceeds $400,000 (married/joint) or $200,000 (single).

The **Health Care Individual Responsibility Tax, "Obamacare Penalty"**, that is, the additional tax you are required to pay if you did not have health insurance (Form 1040, Line 61) **is effectively repealed in 2019** by reducing the tax rate to Zero.

The "**Kiddie Tax"** has been revised. Under the old law, the unearned (that is, income not from working) income of a child under age 19 that exceeded $2,100 was taxed at the higher of the child's tax rate or the parents' tax rate. Beginning in 2018, the child's earned income is taxed at normal Single Person rates, and the child's unearned income is taxed at the Estate and Trust rates, which are the very highest rates.

Section 529 Plans can be used to fund K-12 private school education up to $10,000 per year.

Like-kind Exchanges are eligible for tax-free treatment *only* for real estate transactions, such as exchanging one residence for another. For our clients, the most important effect of this change is the effect on trading-in a *business vehicle* (or other business property) on a new one. The trade-in will result in *a taxable gain or loss*. Exchanges of *non-business* property could result in a taxable gain or a non-deductible loss.

The New Tax Form is designed to look quick and easy, but looks can be deceiving. Instead of having 2 full pages consisting of 79 numbered lines (Lines 1 through 6 were Marital Status and Dependents, so Line 7 was the real first line), the new 1040 consists of two half-pages.

Page 1 contains only your name, address, etc., marital status, dependents, and signature area. These lines are now all un-numbered. Page 2 contains Lines 1-23 which come from various places on both pages of the old Form 1040. Therefore approximately 50 lines have been eliminated. Where did they go? They went to six brand new forms called Schedule 1 through Schedule 6! Amazing ingenuity. Many taxpayers will see *more pages* in their returns than in prior years because of this re-design.

The form for Itemized Deductions (Schedule A) has been shortened because so many deductions have been eliminated.

The combined **Estate and Lifetime Gift Tax Exemption** jumps from $5,490,000 per person to $11,200,000 per person; double those amounts for married couples. This means that only a tiny number of Americans will be subject to the Estate Tax. The **Annual Gift Tax Exclusion** gets its first inflation increase in many years, rising from $14,000 to $15,000 in 2018. This means that you can make gifts of $15,000 or less to as many individuals as you wish without being required to file a Gift Tax Return. Even if you *are* required to file a Gift Tax Return, your tax will most likely be zero because of the $11,200,000 Lifetime Exemption. *Call us if you plan to make gifts of more than $15,000 to any one person.*

BUSINESS TAXES

New 20% deduction for income received from so-called **"Pass-through Entities."** A pass-through entity is an organization such as a partnership, S-corporation, a business owned by one individual, a Real Estate Investment Trust ("REIT"), and in some cases, an ordinary trust. Unlike regular corporations which pay income tax on their profits, pass-through entities do not. Instead, each owner of a pass-through entity is taxed on his/her share of the entity's profits. This amount "passes through" to the owners' tax returns where it is taxed like regular income; that is, at the owner's normal income tax rate.

The new law provides for a deduction by each owner of 20% of his/her profit from pass-through entities. The 20% deduction begins to phase out when the owner's Taxable Income (Form 1040, Line 43) exceeds $315,000 (married filing jointly) or $157,500 (single). *Talk to us* about special rules that apply if your income exceeds these amounts because these rules are extremely complex.

If you are self-employed or the owner or part-owner of a business, this can be of great benefit to you.

Planning idea: It may be possible for people earning salaries or wages to become "businesses" to get the 20% deduction and also get the repealed *employee* business expenses. This could save taxes, but there are downsides. Changing from being an "employee" to a non-employee can cause you to lose many fringe benefits such as 401(k) plan, employer paid health insurance plan, life insurance, sick pay, Unemployment insurance, and others. Purchasing health insurance independently (rather than through an employer) is generally much more expensive. *Talk to us* if want to consider this and you think your employer might be willing to make such an arrangement with you.

Business Losses of individuals can no longer be carried back to prior years, but must be carried forward. In addition, business losses in excess of $500,000 (married/joint) or $250,000 (single) cannot be deducted in the current year, but can only be carried forward.

Business Meals & Entertainment: Business meals remain 50% deductible. *Entertainment* expenses such as tickets to sports events, theater, shows, etc. **are not deductible at all**.

The **tax rate** for regular corporations (not S-Corporations) is 21% effective in 2018, replacing a graduated rate system whose highest rate was 35%.

Depreciation: The 50% "bonus" depreciation on new equipment is increased to 100% for property placed in service on or after 9/28/17 and on or before 12/31/22, meaning that businesses can completely deduct the cost of newly acquired equipment. In addition, the newly acquired equipment *does not have to be new; it can be used*. The same applies to Section 179 depreciation. The limitation on write-offs under Section 179 has been increased from $500,000 to $1,000,000 per year.

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Please call or write if you have any questions or concerns.

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and

Summary of Most Changes

	2017	2018
Auto mileage rate for business	53.5¢ per mile	**54.5¢** per mile
Auto mileage rate for medical & moving expenses	17.0¢ per mile.	**18.0¢** per mile for medical. Moving expense not deductible.
Auto mileage rate for charity	14¢ per mile	14¢ per mile
Long-Term Capital Gains Rates	0%, 15%, 20%	0%, 15%, 20%
Maximum IRA & Roth IRA contribution	$5,500 + $1,000 if over age 55.	$5,500 + $1,000 if over age 55.
Maximum SEP & other defined contribution plans	Lesser of $54,000 or 25% of compensation	Lesser of $54,000 or 25% of compensation
Maximum 401(k),403(b),457 Plan contribution limit	$18,000 + $6,000 if over age 55.	$18,000 + $6,000 if over age 55.
Maximum wages taxable for Social Security	$127,200. Maximum employee tax = $7,886.40	**$128,400**. Maximum employee tax = **$7,960.80**
Social Security Tax Rate Medicare Tax Rate	6.2% 1.45%	6.2% 1.45%
Annual Gift Tax Exclusion (per person receiving gifts)	$14,000	**$15,000**
Estate Tax Exemption per person	$5,490,000	**$11,200,000**
Personal & Dependent Exemption	$4,050	**Zero**
Standard Deduction	Married: $12,700; Single: $6,350; Head of Household: $9,350	Married: **$24,000**; Single: **$12,000**; Head of Household: **$18,000**
Additional Standard Deduction for Age 65 or Blind	Married: $1,250 per spouse. Unmarried: $1,550	Married: $1,300 per spouse. Unmarried: $1,600
Alternative Minimum Tax Exemption	Married: $84,500; Single or Head of Household: $54,300; Married filing Separately: $42,2500	Married: **$109,400**; Single or Head of Household: **$70,300**; Married filing Separately: **$54,700**
Foreign Earned Income Exclusion	$102,100	**$104,100**
Flexible Benefit Account Maximum	$2,600	$2,600
Medical expenses	Amount exceeding 10% of Adjust Gross Income is deductible. Changed to 7.5% for 2017 and 2018.	Amount exceeding **7.5%** of Adjust Gross Income is deductible. Increases to **10%** in 2019.
Maximum deduction for State and Local taxes	No limit	**$10,000**

	2017	2018
Deduction for income from "Pass-Through" entities such as LLCs, Partnerships, S Corporations, Trusts	None	**20% of net income.** State income tax effects of this deduction will vary greatly from state to state,
Maximum mortgage on which interest can be deducted	$1,000,000	**$750,000** effective 12/15/17
Maximum Home Equity Line of credit on which interest can be deducted	$100,000	**Zero** (with certain exceptions)
Deductions Repealed: >Tax preparation fees >Investment advisory fees >Agents' commissions >Employee business expenses (including home office expenses of employee) >Moving expenses >All others that were subject to the 2% of income limit	Total that exceeds 2% of Adjust Gross Income	**Zero**
Additional tax for not having Health Insurance under the Affordable Care Act	Various	Various. **Zero in 2019.**
Child Tax Credit	$1,000 per child. Up to $3,000 is refundable meaning it can be refunded even if you have no tax.	**$2,000** per child. Up to **$1400** per child is "refundable" meaning it can be refunded even if you have no tax.
"Like-Kind" Exchanges	Allowed	Allowed only for real estate. Trade-in of *business* automobile will be a taxable gain or loss.
Business Entertainment	Allowed (50%)	Not allowed.

Disclaimer: This Newsletter is for informational purposes only and is not a substitute for obtaining professional tax and legal advice that is specific to each taxpayer's individual circumstances.