# Overview of Tax Cuts and Jobs Act

January 22, 2018

The recently enacted Tax Cuts and Jobs Act (TCJA) is a sweeping tax package which either modified, repealed or suspended current tax law. Here is a look at some of the important changes that have an impact on individuals, small business owners and investors. Unless otherwise noted, the changes are effective for tax years beginning in 2018 and most individual tax provisions sunset at the end of 2025. The business tax provisions are not subject to this sunset date because they were enacted as permanent. This means the provisions of the new law(TCJA) applicable to individuals were not passed as permanent law changes, rather they were passed as temporary law changes and at the end of 2025, the law sunsets or reverts to 2017 tax law.

As of the time of this writing, **California has not conformed** to this federal tax bill with one minor exception I will note later. Several states have conformed automatically to these tax provisions; however, California is not a state that has automatic conformity and our State elected officials will need to pass a bill to conform to all or part of this federal tax bill.

## Individuals

**Tax rates**. The new law imposes a new tax rate structure with seven brackets: 10%, 12%, 22%, 24%, 32%, 35% and 37%. The top rate was reduced from 39.6% to 37% and applies to taxable income above $500,000 for single filers and $600,000 for married filing jointly, and the marriage penalty is back. The **capital gains and qualified dividend rates** did not change and remain 0%, 15% and 20% and retains additional 3.8 Medicare tax on net investment income for taxpayers with income over $250,000 joint filers and $200,000 single filers. The **"kiddie tax" rules** have been simplified. The unearned income of a child is now taxed at the trust and estate tax rates and will no longer be tied to the parent's and sibling's rates (California doesn't follow this new rule).

The new law increases the **standard deduction** to $24,000 for joint filers, $18,000 for head of household filers and $12,000 for single filers, these amounts will be adjusted annually for inflation. The new law eliminated (suspends) the deduction for **personal exemptions** including dependent exemptions and is replaced with the higher standard deduction and a child and family credit. The **child tax credit** is increased to $2,000 for children under 18 and adds $500 **credit for other non-child dependents**-these credits will begin to phase out when income hits $200,000 single filers and $400,000 joint filers. You will have no exemption credit for yourself or your spouse.

**Alternative minimum tax (AMT)** has been retained for individuals but the exemption amount has been increased. The **estate and gift tax** exemption has been increased to roughly 11.2 million.

**Health care individual mandate penalty** for individuals who fail to obtain minimum essential health coverage is reduced to zero (eliminated) starting in 2019. (Note starting date is 2019) This means if you go without health insurance in 2017 and 2018, you will be subject to the shared responsibility penalty.

For post-2018 divorce decrees**, alimony** will not be deductible by the paying spouse and will not be taxable to the receiving spouse. (Note this does not apply to pre-2018 divorce degrees and separation agreements.)

The deduction for job-related **moving expense** has been eliminated, except for certain military personal. The exclusion for moving expense reimbursement has also been suspended.

There was a lot of talk pertaining to changing the rules for the **home sale exclusion**. The changes did not make it into the new tax bill and thus, we retain as is in current law. Generally, you must live in, and own your home 2 out of 5 years before sale and not have excluded a prior home sale within 2 years of date of sale; you can exclude up to $250,000 for single filers and $500,000 for joint filers

The special rule that permitted **recharacterization of Roth IRA contributions** as traditional IRA contributions **to unwind** a Roth conversion (this was used when market significantly adjusted downward after a Roth conversion was done), has been eliminated. This is one provision in which **California automatically conforms**.

The new tax law allows a qualified distribution **for grades K-12** tuition up to $10,000 for contributions after December 31, 2017 to **529 tuition savings plan**. This is comparable to the rule allowing distributions from Coverdell Educational Savings Accounts to be used for K-12 tuition (Private schools)

**Itemized Deductions**

The itemized deduction for state and local income and property **taxes is limited** to a combined total of $10,000 starting in 2018. **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 $1million), starting with loans taken out in 2018. If you refinance your pre-2018 mortgage and do not pull cash out, you will be able to deduct your mortgage interest using the pre-2018 “grandfathered” in debt limit of $1million. There is **no longer a deduction for interest on home equity loans**, regardless of when the debt was incurred. The disallowance of interest won’t apply to equity lines or seconds loans used to acquire or improve your home provided the total debt doesn’t exceed limits. These limits do not apply to business and rental activities.

The new law retains the deduction for **medical expenses** and temporarily reduces the medical expense threshold back to 7.5% of AGI for 2017 and 2018. The threshold returns to 10% of AGI after 2018.

There is **no longer a deduction for miscellaneous itemized deductions** effective 2018, which were formerly deductible to the extend they exceeded 2 percent of adjusted gross income. This category includes items such as investment expenses, investment advisors, legal costs, tax preparation costs, union dues, uniforms, unreimbursed employee expenses such as mileage, etc. and hobby loss rules expenses.

**Charitable contributions** have been increased from the 50% AGI limitation **to 60% of AGI** limitation.

The itemized deduction for personal **casualty and theft losses has been eliminated** (suspended) except for losses incurred in a “federally” declared disaster. This exception does not apply to a “state or local” governor declared disaster, it must be a federally declared disaster.

The new law **suspends the overall limitation on itemized deductions** that formerly applied to taxpayers whose AGI exceeded specific thresholds.

## Business Owners and Investors

The internal revenue code (IRC) section1031 deferral of gain on **like-kind exchange rules are modified** to provide that the nonrecognition is **limited to real property.** Deferral of gain on like-kind exchange of personal property is eliminated. Generally, applies to exchanges completed after 12/31/17.

Tax deductions for **entertainment and certain meals expense are eliminated**. Expenses for entertainment, amusement, and recreation are not deductible. Dues for a club organized for business, pleasure, or social purposes is not deductible. Meals provided for the convenience of the employer at or near the employer’s premises are not deductible.

The rule allowing the two-year **carry back of net operating losses (NOL) has been repealed** for NOL's arising in tax years ending after 2017(except for farming losses). NOL's may be carried forward indefinitely, however, the NOL deduction is limited to 80% of taxable income.

Expense for **Bonus depreciation** is increased to 100% for equipment effective 9/27/17 to 12-31-22. The requirement that the property must be "new" to qualify is suspended

The IRC section 179 **first year expensing of business equipment is increased to $1 million per year**. The definition of qualified real property eligible for IRC **section 179 expensing is expanded** to include any of the following improvements to nonresidential real property: roofs, heating, ventilation, and air-conditioning; fire protection and alarm systems; and security systems.

**Luxury auto depreciation limits increased** for passenger automobiles for which bonus depreciation is not claimed.

The new law cuts the **corporate tax rate to a flat 21%** this applies to C corporations including personal service C corporations. This does not apply to flow through entities or S corporations.

**New deduction for "qualified Business income"** Starting in 2018, individual taxpayer generally may **deduct 20% of income** from a flow through entity such as a partnership, LLC, S corporation, trust **and** a sole proprietor. The business must be a trade or business within the U.S. Investment income doesn't qualify. This deduction may not exceed 20% of the taxpayer's taxable income reduced by net capital gains. Qualified trade or business is determined for each qualified trade or business and **it appears this deduction applies to most rental properties** (unless the IRS issues regulations telling us different, the law refers to passive and active income.) Subject to a taxable income threshold, the deduction is not allowed with respect to **"specified service trade or business".** What this means for you is **even if your business is considered a specified service business, as listed below, you can take this 20% deduction, if your taxable income is $315,0000 joint filers and $157,000 single filers or less. Specified service business is** any trade or business involving the **performance of services in the field of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests and any trade of business where the principal asset of such trade or business is the reputation or skill of one or more of its employees**. Engineers and architects are omitted from the specified service trade or business definition. If your income is over the above threshold amounts ($157K and $315K), you will not be allowed this deduction if you are service business as defined above. Further, if you are not a service business and your income is over the above threshold, there are additional limitations and calculations that will apply in determining your deductible amount of the 20%.

**Excess business loss limited** for each tax year of a taxpayer other than a C corporation. Starting in 2018, generally, if your business shows a loss in any current year, you will may be limited as to the amount of that loss you can deduct in the current year. Any loss disallowed because your income is above certain thresholds is carried forward as an NOL. This new law is to prevent you from offsetting your other types of income against large business loss if your total income is above these amounts. This is a generalization of the rule and if or when this applies to your situation, I will discuss with you further at that time.

These are a few of the changes that will impact most of us. If you have questions about the impact of your tax returns, please contact me or we can discuss during your tax interview appointment.

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