2017 Tax Reform - Are you a winner or a loser?

For the last few weeks my phones have been ringing more often than usual for this part of the year. Everybody was interested, concerned, or just curious about the new tax law that has been signed by President Trump earlier this week. Obviously, I did not want to commit myself to any concrete answers until the law has been signed and the final version has been made public. I hoped that after reviewing the provisions of the new law and selecting items relevant to most of my clients I would be able to answer the only question that everybody is interested in: Will I be paying more or less income taxes?

Despite many years in practice my judgement and expectations proved me very wrong. The law is so extensive that it is impossible to answer the question above without a detailed analysis of the individual numbers.

What I will try to do, though, is to describe several key provisions that should be clear to everyone and give a few examples that I calculated manually in an attempt to give you, my readers, a certain feel for the numbers that you can expect when the law is finally implemented in 2018.

At the close of 2017 I would like to highlight some of the provisions of the new law that are relevant to both individual and business clients. Sit tight, as I jump right in. The tax tips will follow!

Individual tax changes

Standard deduction and personal exemptions. In 2017 an individual who earned $10,450 (standard deduction and personal exemptions) does not owe any federal income taxes. This amount goes up to $20,800 for a family of two filing a joint tax return. The new law suspends personal exemptions. (When I use the word suspends it means that the law changes are not permanent and might be reverted after 2025.) In 2016 an individual will not owe federal income taxes if she earned $12,000 (standard deductions). Same applies to a family of two who file a joint return if they earned $24,000.

Itemized deductions. Most of my clients take advantage of itemized deductions. Through itemized deductions the government allows the taxpayers to lower the taxable income and consequently income taxes. Itemized deductions include deductions for state and local income taxes (SALT), real estate taxes, mortgage interest deductions, charitable deductions, deductions for unreimbursed employee business expenses, theft and casualty loses, etc. This line item of the tax return sustained most of the changes.

State and local income taxes together with real estate taxes are now limited to only $10,000. Mortgage interest deduction is limited to the mortgage amount of $750,000. This change does not affect those who already have mortgages, who have signed contract by December 15, and who will refinance existing mortgage that is higher than $750,000. It seems that deducting interest from the line of credit up to $100,000 has been suspended. Charitable deductions have been increased: the new law allows 60% deduction on donation versus 50% in the old law. Deductions for unreimbursed employee business expenses, theft and casualty loses have been suspended. The latter is being allowed only in the federally declared disaster areas.

Tax rates. Tax rates have been lowered across the board. There are still seven tax rates. The lowest rate of 10% stays almost without any changes. The next rate went down from 15% to 12% and effects individuals with the taxable income not over $38,700 (MFJ $77,400). The most effected groups are the higher earners with the taxable incomes above $38,700 (MFJ $77,400). They lose the most in the itemized deduction, at the same time they have significant saving because of the rate decrease.

Business tax changes

I would like to mention just a few:

- Corporate tax rate is set at a flat rate of 21%, down from 35%. Discounted rate of 15% for corporate income under $50,000 seems to be eliminated.
- S corporation owners get 20% deduction of qualified business income. This deduction applies to service industry (doctors, accountants, attorneys, etc.) if the income on the personal tax return is below $157,500 for individuals or $315,000 for joint returns.
- There are significant changes in the treatment of amortizable property beneficial for businesses.
- Net Operating Loss deduction cannot be carried back anymore and can be deducted only up to 80% of taxable income.
- Qualified transportation fringe benefits and entertainment expenses are disallowed.
- Like-kind exchanges for real property are limited to exchange of real property that is primarily held not for sale, i.e. you cannot use 1031 exchange for flips.

I realize that by his time I bored you a lot. But if you are still with me I want to share a few examples that you should be able to map to your personal tax situation. If not – feel free to give us a call. We are always happy to speak with you.

Example 1. A married couple with 2017 Adjusted Gross Income (AGI) of $190,000 and Itemized deductions of $57,802 ($15,502 SALT, $16000 Real Estate taxes, $26,300 mortgage interest deduction) pays $22,502 in taxes in 2017. Per new tax law their AGI stays the same, their itemized deductions will go down to $36,300. Their tax will go up to $25,693.

Example 2. The **s**ame couple as in Example 1 but $100,000 they receive as salary and $90,000 as a profit from an S corporation that they own. The taxable income will go down to $135,700 and income tax will be $21,733.

Example 3. The **s**ame couple as in Example 1 but in 2017 they have standard deductions of $12,700 and personal exemptions of $8,100. Their federal income tax in 2017 is $34,261. Per new tax law the federal income tax in 2018 will be $28,399. A huge decrease.

Please note that it is still too early to know how exactly all parts of the law will play out, as IRS is just starting to work on its implementation. All calculations have been made manually. Thus, the numbers above are just estimates.

What does it mean to me? What I described so far is just the tip of an iceberg. As always, the devil is in the details. The IRS and the Congress will continue to work on the implementation of the new law and additional details will be revealed. I will try to promptly update you on all the developments.

Tips for 2017 & 2018

1. If you can prepay 2018 real estate taxes, please do. You still have a few days left in 2017.
2. If you have any unpaid estimated taxes for 2017 please pay them before the end of this year. It will help in 2017 and will not be wasted in 2018.
3. Despite some published suggestions of prepayment of 2018 state and local income taxes do not do it. Code Sec. 164(b)(6), as amended by Act Sec. 11042, states that a taxpayer who, in 2017, pays an income tax that is imposed for a tax year after 2017, can't claim an itemized

deduction in 2017 for that prepaid income tax.

4. Some corporate owners should consider switching from C corporations to S corporations. The decision should be made individually. I will be happy to discuss with you the pros and cons of such a decision.

Stay tuned.