January 8, 2018

Business Tax Matters—2017/2018

After no major tax reform in quite a few years, Congress decided it was time for the most extensive tax reform in a few generations. Or maybe the most extensive ever. Some of the business tax changes will get revised and amended over the year(s) as they figure out how to close loopholes and report the new laws on tax forms. NOTE that all business tax changes take effect January 1, 2018. Hence, the 2017 tax returns we will be preparing soon are generally not affected by the new tax laws.

This Business Tax Matters Newsletter will comprise of two letters. This two-page letter consists of general tax issues and some of the main tax reform topics affecting our clients. The other newsletter will cover the largest of all the small business provisions… the deduction for flow through businesses like S-Corporations, LLC's and sole proprietorships.

Business Engagement Letters: If you are a corporation or two-member LLC or partnership, you most likely have received or are receiving with this mailing our 2017 tax return engagement letter. We kindly ask that you sign, date and return our copy of the engagement letter as soon as you receive it. Thank you!

New IRS rates for 2018:
Mileage rate for business miles: 54.5 cents (2017 rate was 53.5).
FICA wage base cap: $128,400 (2017 cap was $127,200).
Health Savings Accounts (HSA) maximums: $3,450 self-only; $6,900 family; $1,000 additional in both cases for being at least 55 years old. (2017 amounts were $3,400 and $6,750 respectively, plus the $1,000).
Retirement Accounts:

1. Qualified plans like 401k or 403b, maximum deferral increases $500 in 2018 to $18,500. The "catch up" provision for participants at least 50 years old remains at $6,000.
2. Simple IRA plan contribution maximums remain at $12,500, plus $3,000 additional for over 50.
3. SEP IRA maximum is increased to $55,000 in 2018, up $1,000 from the prior year.

Michigan Minimum Wage has increased to $9.25 as of January 1, 2018. New online resources are available at www.michigan.gov/wagehour and www.michigan.gov/lara to help workers and employers understand the facts as the new rate takes effect. Information on youth training wages, the 85% rule for teens 16-17 years old, and for tipped employees can be found at these website links.

S-Corporation Health Insurance:
Shareholders of S-Corporations have many unique rules that don't apply to shareholders of C-Corporations and other entity types. One main rule is they have to add the cost of their employer provided health insurance to their W-2 as taxable income. That health insurance has to have been paid through the corporation or, if paid personally, reimbursed to the shareholder by the corporation. There are other rules related to this issue, so please contact our office if you have questions. If we prepare your W-2's, we will need that information.

(continued)

Tax Reform for Businesses, effective January 1, 2018:

This is just a very basic recap of some of the changes that will affect most of our clients in some way. Perhaps the biggest change for most small businesses is called the "flow-through" deduction. This change may affect profitable S-Corporations, LLC's, partnerships, and sole proprietorships. The next page will address that new law separately. The changes noted below affect all businesses starting 2018.

1. Top corporate tax rate (for C-Corporations) is lowered from 35% to 21%. The 21% is a flat rate from the first dollar of taxable income (no more graduated corporate rate structure).

2. Entertainment expense is repealed. While business meals are still deductible, entertainment expenses are not. Hence, businesses should change their chart of accounts to include three separate line items: Travel, Meals, and Entertainment, as each one is treated differently for tax purposes. An expense is considered to be entertainment if it is for 1) an activity that is generally considered entertainment, amusement, or recreation; 2) membership dues for any club organized for business, pleasure, recreation, or other social purpose; or 3) a facility or portion thereof used in connection with the above.

3. Depreciation rules changed again. The easiest way to summarize these changes are to say businesses should be able to deduct just about everything they pay for factory or office machinery and equipment in one way or another… as long as they are profitable. Some of these deduction decisions can be made when the tax return is prepared, as choosing the "optimum" depreciation isn't always the "maximum". Certain NONRESIDENTIAL real property may now be written off fully in many situations, such as roofs; heating, ventilation and air-conditioning property; and fire protection, alarm and security systems.

4. Accounting methods: The Act expanded the list of taxpayers that are eligible to use the cash method of accounting, and also whether they are required to keep inventories. Basically, businesses with under $25 million in average gross receipts are able to choose these options. More rules may apply, so we may review this on a client by client basis.

5. Net operating losses: Prior law allowed C-Corporations to carry back a loss up to two years and recover taxes paid in those previous years. That is now only available for farm corporations. All losses will be carried forward to future years, with some limits as to how much future income can be offset.

6. Domestic Production Activities: This deduction for certain domestic producers is no longer available.

As we prepare 2017 business and personal income tax returns, we will be looking at the potential tax effect of this major tax reform act on 2018 tax returns. If you have questions please contact our office. As a reminder, the "flow-through" deduction that could affect most profitable companies in a positive way is included on a separate page.

Thank you for allowing us to continue to assist with your tax and accounting needs.

Gould, Stinson & Comer, PC

January, 2018

New 20% “Flow-through” Deduction in 2018

A significant new tax deduction takes effect in 2018 under the new Tax Cuts and Jobs Act. **It should provide a substantial tax benefit to individuals with "qualified business income" from a partnership, S-Corporation, LLC, or sole proprietorship**. This income is sometimes referred to as "pass-through" or “flow through” income, because the income or loss is not taxed at the business level, but flows through to the owner/partner/shareholder’s personal tax return (Form 1040).

The deduction is 20% of your qualified business income (QBI) from a partnership, S-Corporation, or sole proprietorship, defined as the net amount of items of income, gain, deduction, and loss with respect to your trade or business. The business must be conducted within the U.S. to qualify, and specified investment-related items are not included, e.g., capital gains or losses, dividends, and interest income (unless the interest is properly allocable to the business). The trade or business of being an employee does not qualify. Also, QBI does not include reasonable compensation received from an S corporation, or a guaranteed payment received from a partnership for services provided to a partnership's business.

The deduction is taken "below the line;" i.e., it reduces your taxable income but not your adjusted gross income. This basically means the deduction that is calculated will be reported on Page 2 of the 1040, after the calculation of Adjusted Gross Income which is located at the bottom of Page 1. This way, states will generally not be affected by this new deduction since most states, like Michigan, rely in some way on AGI as a starting point. But it is available regardless of whether you itemize deductions or take the standard deduction. In general, the deduction cannot exceed 20% of the excess of your taxable income over net capital gain. If QBI is less than zero it is treated as a loss from a qualified business in the following year.

Rules are in place to deter high-income taxpayers in *certain industries* from attempting to convert wages or other compensation for personal services into income eligible for the deduction. These specific businesses involve the performance of services in the fields of health, law, accounting, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners. For these “specified service” taxpayers with taxable income above $157,500 ($315,000 for joint filers), the deduction starts to be phased out, and is completely phased out at $207,500 for single taxpayers and $415,000 for joint. These amounts are the taxable income on the taxpayer’s respective personal income tax returns. NOTE: If your business is NOT one of these professions noted above, odds are you are not subject to these income phase outs, and may be able to utilize the “flow-through” deduction fully.

Obviously, the complexities surrounding this substantial new deduction can be formidable, especially if your taxable income exceeds the thresholds discussed above. If you wish to work through the mechanics of the deduction with us, with particular attention to the impact it can have on your specific situation, please give us a call.

Gould, Stinson & Comer, PC

Corporate income tax rate drops to 21%, and individual rate brackets are modified under new tax law.

We are writing to inform you about changes to the individual and corporate income tax rates that take effect beginning in 2018 under the major piece of tax legislation called the Tax Cuts and Jobs Act (the Act).

Rate changes for individuals. Individuals are subject to income tax on "ordinary income," such as compensation, and most retirement and interest income, at increasing rates that apply to different ranges of income depending on their filing status (single; married filing jointly, including surviving spouse; married filing separately; and head of household). Currently those rates are 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%.

New rates. Beginning with the 2018 tax year and continuing through 2025, there will still be seven tax brackets for individuals, but their percentage rates will change to: 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

Bottom line. While these changes will lower rates at many income levels, determining the overall impact on any particular individual or family will depend on a variety of other changes made by the Tax Cuts and Jobs Act, including increases in the standard deduction, loss of personal and dependency exemptions, a dollar limit on itemized deductions for state and local taxes, and changes to the child tax credit and the taxation of a child's unearned income, known as the Kiddie Tax.

Capital gain rates. Three tax brackets currently apply to net capital gains, including certain kinds of dividends, of individuals and other noncorporate taxpayers: 0% for net capital gain that would be taxed at the 10% or 15% rate if it were ordinary income; 15% for gain that would be taxed above 15% and below 39.6% if it were ordinary income, or 20% for gain that would be taxed at the 39.6% ordinary income rate.

The Act, generally, keeps the existing rates and breakpoints on net capital gains and qualified dividends. For 2018, the 15% breakpoint is: $77,200 for joint returns and surviving spouses (half this amount for married taxpayers filing separately), $51,700 for heads of household, and $38,600 for other unmarried individuals. The 20% breakpoint is $479,000 for joint returns and surviving spouses (half this amount for married taxpayers filing separately), $452,400 for heads of household, and $425,800 for any other individual (other than an estate or trust).

Important: These new individual income tax rates will not affect your tax on the return you will soon file for 2017, however they will almost immediately affect the amount of your wage withholding and the amount, if any, of estimated tax that you may need to pay.

A related change is that the future annual indexing of the rate brackets (and many other tax amounts) for inflation, which helps to prevent "bracket creep" and the erosion of the value of a variety of deductions and credits due solely to inflation, will be done in a way that generally will recognize less inflation than the current method does. While it won't be very recognizable immediately, over the years this will push some additional income into higher brackets and reduce the value of many tax breaks.

Corporate income tax rate drop. C corporations currently are subject to graduated tax rates of 15% for taxable income up to $50,000, 25% (over $50,000 to $75,000), 34% (over $75,000 to $10,000,000), and 35% (over $10,000,000). Personal service corporations pay tax on their entire taxable income at the rate of 35%. (The benefit of lower rate brackets was phased out at higher income levels.)

Beginning with the 2018 tax year, the Act makes the corporate tax rate a flat 21%. It also eliminates the corporate alternative minimum tax.

I hope this information helps you understand these changes. Please call us if you wish to discuss how they or any of the many other changes in the Act could affect your particular tax situation, and the possible planning steps you might consider in response to them.

END

New 20% deduction for qualified business (pass-through) income under new tax law.

We are writing to inform you of a significant new tax deduction taking effect in 2018 under the new tax law, the Tax Cuts and Jobs Act (the Act). It should provide a substantial tax benefit to individuals with “qualified business income” from a partnership, S corporation, LLC, or sole proprietorship. This income is sometimes referred to as “pass-through” income.

The deduction is 20% of your “qualified business income (QBI)” from a partnership, S corporation, or sole proprietorship, defined as the net amount of items of income, gain, deduction, and loss with respect to your trade or business. The business must be conducted within the U.S. to qualify, and specified investment-related items are not included, e.g., capital gains or losses, dividends, and interest income (unless the interest is properly allocable to the business). The trade or business of being an employee does not qualify. Also, QBI does not include reasonable compensation received from an S corporation, or a guaranteed payment received from a partnership for services provided to a partnership's business.

The deduction is taken “below the line,” i.e., it reduces your taxable income but not your adjusted gross income. But it is available regardless of whether you itemize deductions or take the standard deduction. In general, the deduction cannot exceed 20% of the excess of your taxable income over net capital gain. If QBI is less than zero it is treated as a loss from a qualified business in the following year.

Rules are in place (discussed below) to deter high-income taxpayers from attempting to convert wages or other compensation for personal services into income eligible for the deduction.

For taxpayers with taxable income above $157,500 ($315,000 for joint filers), an exclusion from QBI of income from “specified service” trades or businesses is phased in. These are trades or businesses involving the performance of services in the fields of health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners. Here's how the phase-in works: If your taxable income is at least $50,000 above the threshold, i.e., $207,500 ($157,500 + $50,000), all of the net income from the specified service trade or business is excluded from QBI. (Joint filers would use an amount $100,000 above the $315,000 threshold, viz., $415,000.) If your taxable income is between $157,500 and $207,500, you would exclude only that percentage of income derived from a fraction the numerator of which is the excess of taxable income over $157,500 and the denominator of which is $50,000. So, for example, if taxable income is $167,500 ($10,000 above $157,500), only 20% of the specified service income would be excluded from QBI ($10,000/$50,000). (For joint filers, the same operation would apply using the $315,000 threshold, and a $100,000 phase-out range.)

Additionally, for taxpayers with taxable income more than the above thresholds, a limitation on the amount of the deduction is phased in based either on wages paid or wages paid plus a capital element. Here's how it works: If your taxable income is at least $50,000 above the threshold, i.e., $207,500 ($157,500 + $50,000), your deduction for QBI cannot exceed the greater of (1) 50% of your allocable share of the W-2 wages paid with respect to the qualified trade or business, or (2) the sum of 25% of such wages plus 2.5% of the unadjusted basis immediately after acquisition of tangible depreciable property used in the business (including real estate). So if your QBI were $100,000, leading to a deduction of $20,000 (20% of $100,000), but the greater of (1) or (2) above were only $16,000, your deduction would be limited to

$16,000, i.e., it would be reduced by $4,000. And if your taxable income were between $157,500 and $207,500, you would only incur a percentage of the $4,000 reduction, with the percentage worked out via the fraction discussed in the preceding paragraph. (For joint filers, the same operations would apply using the $315,000 threshold, and a $100,000 phase-out range.)

Other limitations may apply in certain circumstances, e.g., for taxpayers with qualified cooperative dividends, qualified real estate investment trust (REIT) dividends, or income from publicly traded partnerships.

Obviously, the complexities surrounding this substantial new deduction can be formidable, especially if your taxable income exceeds the thresholds discussed above. If you wish to work through the mechanics of the deduction with us, with particular attention to the impact it can have on your specific situation, please give us a call.

End

Limit on state and local tax deduction under new tax law.

We are writing to inform you about new limit placed on individuals' itemized deductions of various kinds of nonbusiness taxes, which was made by the massive Tax Cuts and Jobs Act (the Act), effective beginning with the 2018 tax year.

Before the changes were effective, individuals were permitted to claim the following types of taxes as itemized deductions, even if they were not business related:

- (1) state, local, and foreign real property taxes;
- (2) state and local personal property taxes; and
- (3) state, local, and foreign income, war profits, and excess profits taxes.

Taxpayers could elect to deduct state and local general sales taxes in lieu of the itemized deduction for state and local income taxes.

Tax deduction cuts. For tax years 2018 through 2025, the Act limits deductions for taxes paid by individual taxpayers in the following ways:

- . . . It limits the aggregate deduction for state and local real property taxes; state and local personal property taxes; state and local, and foreign, income, war profits, and excess profits taxes; and general sales taxes (if elected) for any tax year to $10,000 ($5,000 for marrieds filing separately). *Important exception:* The limit doesn't apply to: (i) foreign income, war profits, excess profits taxes; (ii) state and local, and foreign, real property taxes; and (iii) state and local 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.
- . . . It completely eliminates the deduction for foreign real property taxes unless they are paid or accrued in carrying on a trade or business or in an activity engaged in for profit.

To prevent avoidance of the $10,000 deduction limit by prepayment in 2017 of future taxes, the Act treats any amount paid in 2017 for a state or local income tax imposed for a tax year beginning in 2018 as paid

on the last day of the 2018 tax year. So an individual may not claim an itemized deduction in 2017 on a pre-payment of income tax for a future tax year in order to avoid the $10,000 aggregate limitation.

I hope this information helps you understand these changes. Please call us if you wish to discuss how they or any of the many other changes in the Act could affect your particular tax situation, and the planning steps you might consider in response to them.

End

Whether home mortgage interest and home equity loan interest are deductible under the new law.

We are writing to let you know about changes in the rules for deducting qualified residential interest, i.e., interest on your home mortgage, under the Tax Cuts and Jobs Act (the Act).

Under the pre-Act rules, you could deduct interest on up to a total of $1 million of mortgage debt used to acquire your principal residence and a second home, i.e., acquisition debt. For a married taxpayer filing separately, the limit was $500,000. You could also deduct interest on home equity debt, i.e., other debt secured by the qualifying homes. Qualifying home equity debt was limited to the lesser of $100,000 ($50,000 for a married taxpayer filing separately), or the taxpayer's equity in the home or homes (the excess of the value of the home over the acquisition debt). The funds obtained via a home equity loan did not have to be used to acquire or improve the homes. So you could use home equity debt to pay for education, travel, health care, etc.

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). However, for acquisition debt incurred before Dec. 15, 2017, the higher pre-Act limit applies. The higher pre-Act limit also applies to debt arising from refinancing pre-Dec. 15, 2017 acquisition debt, to the extent the debt resulting from the refinancing does not exceed the original debt amount. This means you can refinance up to $1 million of pre-Dec. 15, 2017 acquisition debt in the future and not be subject to the reduced limitation.

And, importantly, starting in 2018, there is no longer a deduction for interest on home equity debt. This applies regardless of when the home equity debt was incurred. Accordingly, if you are considering incurring home equity debt in the future, you should take this factor into consideration. And if you currently have outstanding home equity debt, be prepared to lose the interest deduction for it, starting in 2018. (You will still be able to deduct it on your 2017 tax return, filed in 2018.)

Lastly, both of these changes last for eight years, through 2025. In 2026, the pre-Act rules are scheduled to come back into effect. So beginning in 2026, interest on home equity loans will be deductible again, and the limit on qualifying acquisition debt will be raised back to $1 million ($500,000 for married separate filers).

If you would like to discuss how these changes affect your particular situation, and any planning moves you should consider in light of them, please give us a call.

End

New treatment of alimony under the new tax law.

The Tax Cuts and Jobs Act (the Act) has made changes to the tax treatment of alimony that you will be interested in. These changes take effect for divorce agreements and legal separation agreements executed *after 2018.*

Current rules. Under the current rules, an individual who pays alimony or separate maintenance may deduct an amount equal to the alimony or separate maintenance payments paid during the year as an “above-the-line” deduction. (An “above-the-line” deduction, i.e., a deduction that a taxpayer need not itemize deductions to claim, is more valuable for the taxpayer than an itemized deduction.)

And, under current rules, alimony and separate maintenance payments are taxable to the recipient spouse (includible in that spouse's gross income).

New rules. Under the Act rules, there is no deduction for alimony for the payer. Furthermore, alimony is not gross income to the recipient. So for divorces and legal separations that are executed (i.e., that come into legal existence due to a court order) after 2018, the alimony-paying spouse won't be able to deduct the payments, and the alimony-receiving spouse doesn't include them in gross income or pay federal income tax on them.

New rules don't apply to existing divorces and separations. It's important to emphasize that the current rules continue to apply to already-existing divorces and separations, as well as divorces and separations that are executed *before 2019.*

Some taxpayers may want the Act rules to apply to their existing divorce or separation. Under a special rule, if taxpayers have an existing (pre-2019) divorce or separation decree, and they have that agreement legally modified, then the new rules don't apply to that modified decree, unless the modification *expressly provides* that the Act rules are to apply. There may be situations where applying the Act rules voluntarily is beneficial for the taxpayers, such as a change in the income levels of the alimony payer or the alimony recipient.

If you wish to discuss the impact of these rules on your particular situation, please give us a call.

End

Business/Personal Auto Use Worksheet

Year: 2008

Employee or driver name: ______________________

Description of vehicle (yr; model) ______________________

Date of purchase (unless we already have record of it in our depreciation file) __________

Cost of vehicle $ __________

Odometer reading: Beginning __________ Ending ________

Was another vehicle available for personal use?	YES	NO
Was the vehicle available for off-duty personal use?	YES	NO
Do you have evidence to support your deduction?	YES	NO
Is this evidence written?	YES	NO
Are you an officer or owner of the company?	YES	NO

Mileage information:	1/01 – 6/30	7/1 – 12/31	Total miles in 2008 (or total only if even throughout the year).
Total personal miles	________________	________________	________________
Total business miles	________________	________________	________________
Total miles	________________	________________	________________

Prepared by ______________________________ Date ______________

If you have more than one business vehicle, please make copies of this worksheet.

If we add back the value of the personal use of your company auto to your W-2, we should receive this info immediately at the beginning of January.

If you have questions concerning the deductibility of vehicles, including the value of the personal portion in your income, or related rules, please call our office.

We may have some of the vehicle information (date acquired, cost, etc.) in our depreciation schedule of your business. Close estimates of these items would be fine.