Hunter, Hunter & Hunt, LLP
CERTIFIED PUBLIC ACCOUNTANTS
Members of the AICPA

1315 Fourth Street
Eureka, California 95501

Phone 707-476-0674
Fax 707-476-0675
www.hhh-cpa.com

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Dear Client,

The recently enacted Tax Cuts and Jobs Act (TCJA) is a sweeping Federal tax package. These changes are the first major tax law revisions, that will impact all taxpayers, approved in several decades. The complete list of tax law revisions is too numerous for one letter, so we have highlighted selected items that affect many of our clients. We expect that most of our clients will face real change, either for better or worse, on their tax returns for 2018 and future years. Please note that the TCJA is for federal tax law, so states, including California, may not conform to these changes.

- *Tax rates.* The new law imposes a new tax rate structure with seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The rates applicable to net capital gains and qualified dividends were not changed and the "kiddie tax" rules were simplified, but the tax on unearned income of a child is higher. Ordinary income rates for trusts and estates reach a tax rate of 37% with only $12,500 of unearned income.
- *Standard deduction.* The new law increases the standard deduction to $24,000 for joint filers, $18,000 for heads of household, and $12,000 for singles and married taxpayers filing separately. Given these increases, many taxpayers will no longer be itemizing deductions on their federal return. These figures will be indexed for inflation after 2018. You may still qualify to itemize on your state tax return.
- *Exemptions.* The new law suspends the deduction for personal exemptions. Thus, starting in 2018, taxpayers can no longer claim personal or dependency exemptions.
- *New deduction for "qualified business income or QBI".* Starting in 2018, taxpayers are allowed a deduction equal to 20 percent of "qualified business income," otherwise known as "pass-through" income, i.e., income from partnerships, S corporations, LLCs, and sole proprietorships. The income must be from a trade or business within the U.S. The deduction is not used in computing adjusted gross income, just taxable income. There are limitations based on W-2 wages paid by the business, the basis of acquired depreciable tangible property used in the business, and service related trades or businesses, such as 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, which may cause the deduction to be reduced or eliminated It may be beneficial to proactively calculate the estimated QBI deduction, so tax saving actions can be taken by year end. This new deduction can create a significant reduction in taxes, but proper education and recordkeeping will be essential.
- *Rental real estate may qualify for the QBI deduction*. A recent IRS clarification of the new tax laws will allow some real estate rentals to qualify for the qualified business income deduction. The main qualifying factor is that the landlord is actively involved in the business, (i.e. is responsible for repairs and maintenance on the property), although the repairs can be performed by other people. If you have triple net leases, the property will not qualify for the deduction. Additionally, self-rented business properties may also receive favorable QBI treatment. Some professional businesses may be excluded from taking the deduction.

- *Qualified Opportunity (QO) Funds.* The tax law changes created two new elections, one that allows for the deferral of gain from the sale of property that is reinvested into an investment in a QO Fund and another to permanently exclude gain from the sale or exchange of the investment in a QO Fund. Assets must generally be held in designated Qualified Opportunity Zones. The zones include portions of Humboldt County. A detailed map of the California zones can be located on the State of California's Department of Finance website at http://dof.ca.gov/Forecasting/Demographics/opportunity_zones/.
- *Child and family tax credit.* The new law increases the credit for qualifying children (i.e., children under 17) to $2,000 from $1,000, and increases to $1,400 the refundable portion of the credit. It also introduces a new (nonrefundable) $500 credit for a taxpayer's dependents who are not qualifying children. The adjusted gross income level at which the credits begin to be phased out has been increased to $200,000 ($400,000 for joint filers).
- *State and local taxes (known as SALT).* The itemized deduction for state and local income and property taxes is limited to a total of $10,000 starting in 2018. For people with high wages or significant real property taxes deducted on Schedule A, this change could have a significant impact on federal taxes.
- *Mortgage interest.* Under the new law, 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 $1 million), starting with loans taken out in 2018. Loans from years prior to 2018 are grandfathered and can be refinanced as long as the principal amount doesn't increase. There is no longer any deduction for interest on home equity loans, regardless of when the debt was incurred, unless the debt is used for home acquisition or improvements. Consideration for these new rules will be important when purchasing or refinancing personal residences.
- *Charitable Contributions.* The new tax law increases the limits allowed for cash donations to qualified charities. However, due to changes in the standard and itemized deduction rules, planning will be needed to maximize the tax impact of contributions.
- *Miscellaneous itemized deductions.* There is no longer a deduction for miscellaneous itemized deductions on the federal return, which were formerly deductible to the extent they exceeded 2 percent of adjusted gross income. This category included items such as tax preparation costs, investment expenses, union dues, and unreimbursed employee expenses.
- *Medical expenses.* Under the new law, for 2017 and 2018, medical expenses are deductible to the extent they exceed 7.5 percent of adjusted gross income for all taxpayers. Previously, the AGI "floor" was 10% for most taxpayers, and it returns to that level in 2019.
- *Casualty and theft losses.* The itemized deduction for casualty and theft losses has been suspended except for losses incurred in a federally declared disaster area.
- *Overall limitation on itemized deductions.* The new law suspends the overall limitation on itemized deductions that formerly applied to taxpayers whose adjusted gross income exceeded specified thresholds, so no phase-out will occur.
- *Moving expenses.* The deduction for job-related moving expenses has been eliminated, except for certain military personnel. The exclusion for moving expense reimbursements has also been suspended.

- *Alimony.* For post-2018 divorce decrees and separation agreements, alimony will not be deductible by the paying spouse and will not be taxable to the receiving spouse. Existing alimony agreements are grandfathered in, unless they are revised subsequent to 2018.
- *Health care "individual mandate".* Starting in 2019, there is no longer a penalty for individuals who fail to obtain minimum essential health coverage.
- *2018 annual gift tax exclusion.* The annual exclusion has increased from $14,000 in 2017 to $15,000 in 2018. The exclusion is expected to increase periodically to offset inflation.
- *Estate and gift tax exemption.* Effective for decedents dying, and gifts made, in 2018, the estate and gift tax exemption has been increased to roughly $11.2 million ($22.4 million for married couples).
- *Alternative minimum tax (AMT) exemption.* The AMT has been retained for individuals by the new law, but the exemption has been increased to $109,400 for joint filers ($54,700 for married taxpayers filing separately), and $70,300 for unmarried taxpayers. The exemption is phased out for taxpayers with alternative minimum taxable income over $1 million for joint filers, and over $500,000 for all others.

Please note that the changes in tax law will take time to implement for financial institutions, federal and state governments, businesses and accountants. The filing of your tax returns may be delayed as a result, so please be patient if your tax return must go on extension.

As you can see from this overview, the new law affects many areas of taxation. For many taxpayers, federal tax will be reduced in 2018, but taxpayers with significant assets and income may face an unwelcome surprise on their next tax return. We welcome the opportunity to help you navigate these major changes in tax law and take advantage of the new benefits available to you. If you have any questions or concerns, please give us a call or schedule an appointment at 707-476-0674.

Very truly yours,

The Hunter, Hunter & Hunt Team