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Implications of the Tax Reform to Individuals

There has been a great deal of speculation about the new tax laws & how they will affect us. The "Tax Cuts and Jobs Act" has been signed by the President. Now the bill goes to the IRS, where it will be converted into tax law. It could take 3-4 months before we have actual tax law. Because the bill was debated behind closed doors and passed at breakneck speed, practitioners do not have the benefit of "Congressional Intent" to help decipher what the new law was meant to accomplish. So, although much of what I'll discuss below has been widely reported, the final law may not reflect all of what is below.

There are long term and short term actions to consider with any tax change. There is a "one year" window for those who have the potential to prepay real estate taxes in 2017, for example. Importantly, there were no changes in retirement account contribution amounts or deductibility. A number of deductions are no longer allowed, and capital gains limits have been modified. I have outlined many of these in the list below.

As always, if you have any questions, or if I can help you determine your best strategy now, please do not hesitate to call. We will have more time in individual appointments in 2018. For those of you with businesses, I will prepare a separate memo on how the new law impacts business taxation.

I wish you and your family a very healthy and happy new year!

Mark R Villano CPA
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HIGHER STANDARD DEDUCTION

Before: Until 2018, deductions for mortgage, state and real estate taxes (SALT) reduced income directly.

2018: The standard deduction will be doubled to $24,000 for married couples ($12,000 for individuals) & adjusted for inflation starting in 2018. This reduces taxable income and thus could simplify tax returns**. Miscellaneous itemized deductions (e.g. tax-related expenses, investment expenses) are eliminated.**

If you can accelerate any payments into 2017 to qualify for miscellaneous itemized deductions, do so. This Act appears to benefit lower income taxpayers and renters. Taxpayers who have utilized mortgage interest and real estate taxes to lower their taxes may be hurt with this cap. We may see decreasing home values as a consequence in higher real estate tax areas.

LOSS OF EXEMPTIONS

Before: **Until The personal exception deduction was $4,150.**

2018: **Starting in 2018, the personal exception deduction will be eliminated. Thus, your income could be higher.**

The loss of the personal exemption was factored into lower tax rates. Eliminating the personal exemption will help simplify tax preparation, but will adversely affect larger families who may see large reductions in their taxable income from exemptions.

CAP ON STATE, LOCAL & REAL ESTATE TAXES

Before: **Unlimited Schedule A deduction for state, local & real estate taxes (SALT).**

2018: **The new law limits the total combined state, local and real estate deduction to a maximum of $10,000. Foreign property taxes are no longer deductible.**

The usefulness of this major deduction is significantly reduced in most states. Generalities are usually not a good thing in taxes, but this rule of thumb is a good starting point: If you are not subject to the Alternative Minimum Tax (AMT), there is a good chance that you will benefit by prepaying your 2018 state, local, sales and real estate taxes now, in 2017. This could help lower your 2017 federal taxes. The same is true if you pay quarterly estimates for 2017 state income taxes.

If you are currently subject to the AMT, prepaying these taxes almost certainly will not help you lower your 2017 federal taxes. Most certainly, cash flow will determine if you can afford to take advantage of this one-time benefit. Please note- you must make this payment in 2017 to benefit from this.

MORTGAGE & HOME EQUITY INTEREST DEDUCTION

Before: **Taxpayers could deduct mortgage interest on loans secured by their first and second homes up to $1,000,000 ($500,000 for Married Filing Separately (MFS) taxpayers).**

Home equity loan interest up to $100,000 loan value was deductible. Interest on second homes, recreational vehicles/boats was deductible.

2018: **The new law eliminates all Home Equity Loan interest deductions. New home mortgage loans secured after 12/31/17 are limited to an interest deduction on mortgage loans of $750,000 ($375,000 MFS) for first and second homes. Existing mortgages are "grandfathered" if the debt was incurred on or before Dec. 15. 2017. There are additional limitations on mortgage interest deductions which are still in effect from previous law.**

If you can, pay down your Home Equity Loan in 2017. You might consider refinancing with a larger mortgage on your primary home while mortgage rates are low and eliminating as much home equity debt as possible. Consider a larger loan on your primary residence and a lower one on your second home or RV/boat. Other rules regarding home mortgage interest still apply and could reduce your mortgage interest deduction.

MEDICAL EXPENSE DEDUCTION LIMITED

Before: **There were 2 age-dependent thresholds: 10% for those <65, and 7.5% for those >65. So, if your adjusted gross income (AGI) was $10,000, your threshold was $750.00.** You "pour" **your medical deductions into a bucket & the first $750.00 stays in the bucket (eg is not deductible.) Medical deductions over $750 "flow out of the bucket" and are deductible on Schedule A.**

2018: **The new law lowers the threshold for medical expenses to 7.5% for 2017 and 2018 for everyone, regardless of age. In 2019 and thereafter, the adjusted gross income limitation increases to 10%. This, in effect, limits the medical expenses that are deductible for those <65 for 2017 and 2018.**

The law imposing a penalty on individuals who do not purchase health insurance has been repealed.

KIDDIE TAX MODIFIED

Before: A child's unearned income (interest, dividends, capital gains) over a certain amount was taxed at the parents **rate. This limited income shifting between parents and their children.**

2018: **The new law taxes the excess of the first $1,050** of the child's unearned income at trust tax rates. **Trust rates can reach the maximum tax at approximately $12,500 in taxable income.**

CHILD TAX CREDIT MODIFIED

Before: **The current child tax credit is $1,000.**

2018: **The new law provides an increase in the current Child Tax Credit from $1,000 per child to $ 2,000, refundable up to $1,400. Additionally, the income levels that qualify for the increased credit have been broadened.**

The increased credit should also help ameliorate the loss of the personal exemption deduction.

ESTATE GIFT TAX EXEMPTIONS

Before: **The estate gift tax exemption was $5.6 million.**

2018: **Under new law, the $5.6 million exclusion is increased to $11.2 million for an individual or $24 million for a married couple.** Plan to revise you're your Will/Trust as a result of this change.

I believe everyone, regardless of income, should have a current Will, Trust and Health care Power of Attorney. There are also changes to state estate taxes based on changes in the federal law.

CHARITABLE CONTRIBUTION THRESHOLD INCREASED

Before: **Under previous law, the maximum charitable contribution a taxpayer could deduct was limited to 50% of their income, before the excess was carried over to a subsequent year.**

2018: **Under new tax law, that percentage of income is increased to 60% of adjusted gross income for cash gifts to public charities.**

There may be benefit from making large charitable contributions prior to year-end to maximize the charitable income tax deduction in 2017. Also, in future years, "clustering" charitable giving into a single year may benefit those who may not have sufficient itemized deductions to increase the standard exemption.

OTHER CHANGES

CAPITAL GAINS LIMITS MODIFIED: **The 0, 15 and 20% capital gains tax rates were retained. However, the breakpoints for each rate have been increased.**

DEDUCTIONS NO LONGER ALLOWED:

1. **Alimony payments for newly divorced taxpayers after 12/31/18 will no longer be deductible by the payor or taxed by the recipient. People with existing alimony arrangements have some choice over whether or not to adopt this rule.**
2. **Under new tax law, the miscellaneous 2% itemized deduction is no longer allowed.**
3. **Under new law, moving expenses are no longer allowed, except for active military personnel.**
4. **Under new tax law, property and casualty losses are no longer deductible except for those losses incurred in federally declared disaster areas.**

ALTERNATIVE MINIMUM TAX ADJUSTED

Under the new law, the thresholds for individuals subject to the AMT are increased.

529 PLANS ARE EXPANDED

Distributions up to $10,000 tax-free are now allowed for elementary and high school costs per student

UNCHANGED UNDER THE NEW TAX LAW

Most importantly, there were no changes in retirement account contribution amounts or deductibility.

- **Investors can still choose specific lots or shares when selling partial positions of securities.**
- **Exclusion of the gain from sale of a primary residence remains as before.**
- **A 3.8% tax on net investment income is continues.**
- **For 2018, 1031 exchanges continue on the sale of real estate ("like-kind" sales), but this will not be available for other property types in 2019 onward.**
- **IRA conversions from a traditional to a Roth IRA cannot be re-characterized back to a traditional IRA effective in 2018.**
- **Student loan interest is still deductible as well as graduate student tuition waivers.**

There are additional changes and subtleties to the new tax code. I hope this email helps you navigate your initial strategy and year end payments in case you want to take action this week. Certainly, we will review your individual situation during our one-on-one appointments this winter.

Sailing out of Kenosha Harbor aboard the Red Witch, summer 2017

This e-mail should not be considered a comprehensive list or discussion of the new tax law changes. We omitted the change in the tax rates and thresholds due to time and space limitations. There were other changes which were not mentioned which may be important to you. In addition, additional facts may come to light which are at odds with our discussion. Finally, because tax law is complicated, do not use our discussion to make important decisions without consulting us or other competent tax counsel.