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2018 What's New in the Tax Cuts and Jobs Act

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Basic Changes to Federal Tax Reform

- Child Tax Credit
- Individual Tax Rate
- Standard Deduction versus Itemized Deductions
- Different Business Entities
- Corporate Rate and business credit
- Pass-through Income

Child Tax Credit

- 2018 new Child Tax Credit is **$2,000.00** per child
- 2017 and prior years the Child Tax Credit was **$1,000.00** per child
- This credit is applied against the taxpayer's liability to reduce the amount of taxes the taxpayer owes.
- Result: increases the refund to the tax payer.
- This credit is a **refundable credit** which means that if you do not owe any taxes, you still get the credit in the form of a refund.
- This credit benefits only taxpayers with qualified children.

Qualified Children:

- Sons/Daughters
- Foster Children
- Adopted Children
- Any descendant's of these children such as grandchildren

Individual Tax Rates Comparison

Individual Tax Rates in 2017 versus 2018

2017 Percentages	2018 Percentages
10%	10% If income is not over $9,525.00
15%	12% If income is over $9,525.00
25%	22% If income is over $38,500.00
28%	24% If income is over $82,500.00
33%	32% If income is over $157,000.00
35% 39.6%	35% If income is over $200.000.00 37% If income is over $500,000.00

Individual Tax Rates Comparison

- For **low income single taxpayers** with taxable income of $9,525 or less, the rate is the same for 2017 and 2018.
- This taxable amount limitation is higher for those filing as **Head of Household** and/or **Married Filing Joint.**
- Tax rate changes start kicking in at higher taxable brackets such as taxpayers with taxable income over $9,525
- See deductions later

- **Taxable income:**
- Total income less standard deduction or itemized deductions depending on you deductible expenses and applicable credits.
- The reason the taxable income limitation for head of household and married couples is higher is because HOH and MFJ pay less taxes than single and married filing separate taxpayers.

Standard Deductions vs. Itemized

- Standard deduction for 2017:
  - MFJ: $12,700
  - S: $6,350
  - HH: $9,350
- Standard deduction for 2018:
  - MFJ: $24,000
  - S: $12,000
  - HH: $18,000
- Personal exemption for 2017 was $4,050 and repealed to $0.00 for 2018

- Since there are **no personal exemptions** allowed for 2018, you can not deduct exemptions for 2018
- However with the new standard deduction the total deduction was less for 2017 than it is now for 2018.
- Example:
- 2017 standard deduction for married couples is $12,700 + exemption of $4,050 for taxpayer + $4,050 for spouse = **$20,800 total**
- As of 2018, it is $24,000 off the top.
- Result: Higher deduction for income in 2018 in the amount of $3,200 ($24,000.00-$20,800.00) at 10% bracket.
- Result: $320 tax savings for 2018.

More on Itemized Deductions

- Why are people complaining that they are paying more this year?
- The truth is, more people are **NOT** paying more taxes this year.
- Under normal circumstances, taxpayers are **saving more** under the new reform. Especially low income earners that do not itemize.
- The new administration did not do a good job informing employers and tax payers how to adjust their withholdings properly for the 2018 tax year.
- Most employers under withheld from tax payers, not taking in consideration that the savings was an average of $320 per married filing joint couple and an average of $160 per single tax payer per year.
- Result: a tax withholding shortage at the end of the year.
- **Misconception:**
- Most clients assumed they were taking more money home on their paychecks because of their yearly pay raise and not so much for tax reduction.
- **Facts:**
- Changes due to the repeal of many itemized deductions acceptable in 2017 and prior years also affected middle and high income earners.
  - employee personal vehicle expenses
  - limitation of personal property taxes
  - and other employee related expenses

Itemized Deductions Repealed for 2018

- The most prevalent deductions repealed by the new administration for 2018 are:
  - The personal vehicle and other deductions on form 2106 employee related expenss
  - Travel and entertainment expenses for traveling employees
  - Business meals for employees traveling out of the area
  - Job Training
  - Union dues and many other misc. expenses related to professional fees and dues etc.
  - Work shoes, safety equipment, and other employee related deductions. These are still deductible in the State.
- The limit on state and local property taxes is $10,000.
- Misconception: the $24,000 standard deduction increase would take care of everything, but most employees have employee expenses that exceed that amount when you add up:
  - Mortgage interest
  - Property taxes
  - and all other employee related expenses that were deductible in prior years.

Example

- A tax payer with property taxes of $8,000/year
- State income taxes of $4,600/year
- Sales taxes of $3,600/year.
- Total of $16,200 deductible expense in prior years is now limited to only $10,000 for that particular category in 2018. Thus generating an increase in taxes of $620.00
- Taxpayers that own homes in the $500,000.00 range, with property taxes above $6,000.00 per year, and mortgage balances of $300,000.00 or more are more likely to itemizes as their combined mortgage interest and property taxes are most likely to exceed the $24,000.00 standard amount. This group of taxpayers decreased in size specially in low income areas.

6 Different Forms of Business Entities

- Individual/Soler Proprietor or Single member LLC:

1. **LLC (Limited Liability Co.) and Individuals**
   - May have one or more owners.
   - If more than one owner, it must be treated as a partnership.
   - An LLC with only one owner must be treated as a Sole Proprietor same as an individuals.
   - For tax purposes, it is filed on 1040 and schedule C. Unless form 2553 is filed to be treated as corporation.
   - Schedule C is where the business owner itemizes his/her gross income and his business related expenses. An individual that is not registered as an LLC may file as a business owner on Schedule C form 1040 as well.
2. **Corporations: C Corporations and S Corporations.**
   - If incorporated, it must file as C corporation by default.
   - If elected at the option of the incorporating officer, the corporation may be treated as an S Corporation by filing 2553 form in order to be treated as an S Corporation with pass thru income.

Different Tax Consequences for C Corporations and S Corporations

- A disadvantage of a **C Corporation** is that it is double taxed. Once as a C corporation at the corporate tax rate and a second time at the taxpayer tax rate level depending on the shares or dividends received by the taxpayer from the corporation.
- File tax return for C corporations on form 1120.
- The business and corporate tax rate starting in 2018 is 21% compared to 35% in 2017.
- The effective rate may be lower than 21%. In addition, a business credit of 20% may be taken.

- One of the advantages of an **S Corporation** is that it is a passthrough entity.
- The profit of the S corporation is not taxed but the profit is taxed at the taxpayer rate in the taxpayer individual tax return form 1040 schedule K1.
- An S Corporation may not have more than 100 share holders, must be domestic, all shareholders must be individuals and residents, and must have only one class of stock.
- This type of business entity is preferred by most small business owners. Must file taxes on form 1120-S and K1 for shareholders.

Partnerships: General and Limited

- To form a partnership, you must have more than one partner.
- Partnership taxes are filed using form 1065.
- The taxable income of the partners is passed to the partners on the form 1065 K1 according to their shares, then reported on the partner's 1040 form at his/her personal tax rate.
- A partnership may also elect to be treated as a corporation, filing form 8832.
- A general partner is personally liable for the partnership debts.
- A limited partnership has limited liability to the extent of his investment in the partnership.
- In the case of an LLC, the partners are not liable.

Trust and Estates

- The most commonly used form of a trust is a **Revocable Living Trust**.
- The income from a living trust is also treated as pass-thru income by passing the taxable income to the beneficiaries.
- Income activities from a trust are reported on form 1041 but are not taxed to the living trust entity unless the income from the trust is not distributed.
- The income is divided to the heirs according to the amount of beneficiaries in the 1041 K1 forms.
- Some income from living trust such as capital gain may not be taxed to the beneficiary either due to the step up basis exemption that the deceased is entitled to upon his/her death.

More on Estates and Trusts

- If the inherited asset/property is not distributed within the same year that it was inherited (not sold or transferred title when the grantor dies) then the income it generates in form of appreciation, dividends, and/or rent may become taxable at a later date when is sold or the year gain is recognized.
- Most living trusts are designated for assets to be distributed upon the death of the grantor.
- The income is seldom taxable as estate tax unless the net worth is more than $11.2 million (single) and 22.4 million (if married) or the taxable income is more than $600 per year.
- Net worth is not to be confused with taxable income. Net worth is the fair market value of the assets when the grantor passes and taxable income is the income the trust generates from ongoing activities such as rental income after grantor passes.

Why Is My Capital Gain Not Taxed?

- Upon the death of the grantor, the basis of the inherited property is increased to the fair market value at the time the deceased grantor. In other words the cost paid for of the asset becomes higher than originally paid for. This increase in cost or basis results in zero or next to zero gain.
- Real estate assets and stock are usually tax free if sold within a few months after inherited.
- This is because the appreciation is usually not significant a few months after death. If asset held longer periods and sold later at again due to appreciation, then it becomes taxable depending on the amount gained during holding period. Sometime these assets may be rented during the holding period and taxable income may be produced.

Business Deductible Expenses

- The business deductible expenses for the following are relatively the same in terms of category and nature for all businesses:
  - Individual business owners
  - Limited Liability Companies
  - C Corporations
  - S Corporations
  - Partnerships
- The rule of thumb for IRS purposes is that it must be ordinary, necessary, and relevant.
- Ordinary meaning that is not extravagant.

More on Business Expenses

- **Necessary:** the business expense must be indispensable in order to produce income.
- **Relevant:** must be associated with the regular course of conducting the business activity.
- Some of the most common business related expenses are:
  - Auto expenses
  - Space rent
  - Employee wages
  - Contracted labor/services
  - Business asset depreciation
  - If is relevant to the business, all expenses are deductible.

Business Vehicle Expenses

- The most common business expense that gets audited is the business auto expense. The reason is that it is the most abused expense.
- Most small business owners do not keep proper record of the business trip miles and do not separate personal miles from business miles and commuting miles.
- For the year 2018 the business miles allowance is 54.5 cents per mile and gets adjusted periodically every year based on the cost of fuel increase/decrease as per standardized consumer reports. For 2019 it is 58 cents per mile.
- If you choose to use the mileage rate you can not expense the actual costs.
- This is because the mileage rate is already allowing for fuel, repairs, insurance, maintenance, and wear and tear of the vehicle.

Business Space Rent and Depreciation

- The rent and other equipment rental necessary to conduct business is a normal business expense.
- This includes temporary car and machinery rental necessary to conduct business.
- If you own the building or the equipment to conduct business, a wear and tear expense called **depreciation** may be deducted as a business expense depending on the life expectancy of the asset placed in business.
- For example, a business building may be depreciated for 31 years because the useful life expectancy is 31 years.
- A $250,000 building placed in business may have a yearly depreciation expense of $8,064.52 using the strait line method. (250,000/31=8064.52)

Vehicle Depreciation Expense

- You may also depreciate the cost of a business vehicle also known as the **basis of the vehicle**.
- The life expectancy of a passenger car is 5 years. Therefore, using the straight line depreciation method on a $30,000 vehicle, a $6,000 yearly depreciation may be deducted as a business expense.
- Depreciation for furniture is 7 years.
- There are other methods of depreciation, although the strait line is the most commonly used.
- Another popular method is the **actual expense** also known as section 179.
- This method allows for the full expense deduction of the asset up to $1,000, 000 for 2018. This method is more commonly used by larger businesses.
  - With the new tax reform, it includes used property.

Employee and Contractual Expenses

- It is very important to differentiate employee wages from contracted labor or services.
- **<u>Employee:</u>**
  - Individual that works by the hour or salary
  - Employer dictates the schedule and has control of the employee activities
  - Individual is usually bound by an employment contract either in writing or verbally
- **<u>Contractor:</u>**
  - Does the work independently
  - Usually assumes the liability of the finished product or service sold
- IRS normally assumes all workers are employees. Employee wages are reported on a w2 form and the employer is expected to withhold federal, state, social security, Medicare, and sometimes, state disability insurance.

Independent Contracted Labor and Services

- The recipient Independent Contractors' income is given a 1099 MISC FORM by the payer as required by the IRS if the amount paid per year exceeds $600.00.
- Both the employee and the contractor must provide a valid social security number to the payer of wages or independent income.
- Sometimes a taxpayer may not have a valid social security number but is entitled to obtain an ITIN (Individual Tax Identification Number) due to their non-resident status.
- This allows him/her to pay taxes but not to collect benefits on the taxes paid. Contrary to the popular belief that undocumented immigrants do not pay taxes, they do with their ITIN.
- In 2010 undocumented immigrants paid an estimated 10.5 billion in taxes, which was about 8% of their estimated earned income.
- Undocumented workers are unable to collect any benefits due to an invalid social security number. That revenue is used for other federal funding such as military and infrastructures.