SPECIAL EDITION:
Tax Cuts and Jobs Act

NEWS BRIEF

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Tax Cuts and Jobs Act's Impact on Estate Planning

By Michelle Flinn, CPA

With the passage of the Tax Cuts and Jobs Act (TCJA), effective estate planning is as important as ever. Some aspects have not changed; for example, the top estate tax rate remains at 40%, portability of a deceased spousal unused exclusion is still allowed, and the step-up basis rules remain the same.

However, the TCJA does have some significant effects on estate planning. The TCJA doubles the exclusion amount from $5 million (set in 2011) to $10 million, which will be indexed annually for inflation. For 2018, the exclusion amount for combined gift and estate taxes is $11,180,000. The generation-skipping transfer tax exclusion is also $11,180,00 in 2018, which is separate from the combined gift and estate tax exclusion. In 2026, if the provision is not extended, the exclusion will revert to $5 million and will be adjusted for inflation. There has been no legislative resolution on if a "clawback," or addback of gifts made during years with a higher exclusion to the taxable estate, is allowed if the exclusion reverts in 2026 on gifts and transfers made until 2025. This could potentially cause some issues in your estate planning if the clawback does come into play after 2025.

Under the TCJA, the most important part of estate planning will fall into basis-building strategies. Most individuals will not exceed the federal exclusion amount that would result in the estate owing estate taxes. Individuals can leave their assets in their estates and pass those assets to their beneficiaries at a stepped-up basis. A step-up in basis allows for the beneficiary to receive the asset at a basis of the fair market value on the decedent's date of death rather than at the decedent's basis. Using this strategy could help reduce the amount of gain that a beneficiary would have to report if he or she chose to sell the asset, in the case of highly appreciable assets.

Another strategy that can be used in light of the TCJA is to make gifts to older relatives with relatively shorter life expectancies. The relative would be gifted the asset and would then assume the donor's basis in that asset. When the relative passes away, he or she would designate in his or her will that the property is to be bequeathed back to the donor. The donor would then receive a step-up in basis for the asset at the relative's date of death. However, if the relative passes away within one year, there would be no step-up in basis.

It is important to note that although the federal lifetime exclusion has increased, not all state exemptions have increased. New York State did not change its law in response to the TCJA, and at this point there is no indication that it will, so the New York exemption for 2018 is $5,250,000. Since there is such a large gap between the two exclusions, it is important to consider the state exemption amount when planning for your estate. If this gap is left unplanned for, it could be quite costly for your estate.

Whether or not you meet the federal or state exclusion amounts, it is important to regularly review and update your estate plan. It's never too early to start thinking about how to pass along your assets to those you love in the most tax-effective way.

Year-End Tax Planning for Individuals in Light of the TCJA

By Svetlana Svetlichnaya, CPA

The Tax Cuts and Jobs Act represents the most dramatic change to the federal tax code in decades. With these changes taking effect for the 2018 tax year, year-end tax planning is especially important this year. Here are some changes to keep in mind while tax planning:

Reduced Tax Rates

While there are still seven tax brackets, the tax rates have decreased overall to 10%, 12%, 22%, 24%, 32%, and 37%. The standard deduction has almost doubled to $24,000 for married filing jointly, $12,000 for single, $18,000 for heads of household, and $12,000 for married filing separately. Taxpayers who are age 65 or over or blind receive an additional deduction. Personal exemptions have been eliminated entirely.

Itemized Deductions

The largest restriction in itemized deductions includes the deduction for state and local income, and sales and property taxes, which is now limited to a combined total deduction of $10,000 ($5,000 if married filing separately) per tax year. Miscellaneous itemized deductions including items like tax preparation fees, unreimbursed employee business expenses, and investment fees are no longer deductible.

It is important to note that these restrictions are for the federal Form 1040 only. Many states, including New York State, have ruled they will not follow the provisions of the TCJA. Most itemized deductions will continue to be deductible for state purposes.

Maximizing Deductions

Taxpayers should determine what their anticipated itemized deductions for 2018 will be to see whether they will exceed their standard deduction. Those whose current itemized deductions fall far short of the increased standard deduction may want to postpone deductible expenses until next year; those who are close to the standard deduction amount may want to move planned 2019 spending into 2018 to maximize 2018 itemized deductions. Taxpayers may want to consider making charitable contributions every other year to increase the likelihood of itemizing deductions in the year the contributions are paid.

Qualified Charitable Distributions

Taxpayers should also consider the qualified charitable distribution (QCD), available to taxpayers over the age of 70½. A QCD allows a taxpayer claiming the standard deduction to get a tax break for giving to charity. With a QCD, money is transferred from your traditional IRA directly to a charity without the money being added to your adjusted gross income. This may potentially lower your tax bracket and allow you to avoid higher Medicare premiums, the 3.8% net investment income tax, or even the alternative minimum tax. You may donate up to $100,000 per year.

Home Mortgage Interest

Mortgage interest is still deductible, although the limit on the amount of debt that applies has been reduced. If your loan originated on or before December 15, 2017, you may deduct interest on up to $1 million in qualifying debt. If your loan originated after that date, you may only deduct interest on up to $750,000 in qualifying debt. The limits apply to the combined amount of loans used to buy, build, or substantially improve your main and second homes.

Year-End Tax Planning for Businesses in Light of the TCJA

By David Johnson, CPA

The Tax Cuts and Jobs Act (TCJA) has created new tax planning opportunities for businesses to consider. While some of the regulations have not been finalized and additional changes may occur before the 2018 filing season begins, taxpayers should be aware of some of the key changes resulting from the TCJA.

Depreciation and Expensing

Businesses should consider making expenditures that qualify for the liberalized Section 179 expensing option, which allows a deduction for the full cost of the property (not buildings) in the year the property is placed in service. For tax years beginning after December 31, 2017, the expensing limit is $1 million, and the investment ceiling limit is $2.5 million. The Section 179 expense for the tax year may not exceed the amount of taxable income for that tax year.

Businesses that are not able to benefit from Section 179 expensing may be able to benefit from 100% bonus depreciation instead. Bonus depreciation can be taken on tangible personal property that is new or used (must be new to the taxpayer) with a recovery period of 20 years or less and is permitted without any consideration of taxable income.

Businesses may be able to take advantage of the de minimis safe harbor election to expense the costs of lower-cost assets and materials and supplies. To qualify for the election, the cost of a unit of property cannot exceed $5,000 if the taxpayer has an applicable financial statement (a certified audited financial statement) or $2,500 for a taxpayer without an applicable financial statement.

Meals and Entertainment

Under the old law, entertainment expenses (such as taking a client to a baseball game) were 50% deductible. These expenses are no longer allowed. Under the old law, meals provided for the convenience of the employer that were excludable from an employee's gross income as de minimis benefits were 100% deductible. Under the TCJA, all meals provided for the convenience of the employer are only 50% deductible. Qualified employee transportation fringe benefits (such as parking allowances or mass transit passes) are no longer deductible.

Other Changes

Taxpayers with average annual gross receipts of $25 million or less (based on the prior three years) are fully exempt from uniform capitalization (UNICAP) rules that require certain costs normally expensed to be capitalized as inventory for tax purposes.

A new limitation on the deductibility of business losses is in place for tax years 2018–2025. Taxpayers other than C-corporations will not be allowed to deduct the portion of an overall business loss in any given tax year greater than $250,000 for individuals or $500,000 for married couples. Losses disallowed under the passive activity loss rules are not included in the excess loss calculation. Excess losses are treated as part of net operating losses (NOLs) carried forward.

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Section 199A Deduction: What Is It and How Does It Work?

By Christina Larkin, CPA

One of the most discussed provisions of Tax Cuts and Jobs Act is the Section 199A deduction for qualified business income of pass-through entities. It provides a deduction to non-corporate taxpayers (individuals, trusts, and estates) with income from partnership, S-corporation and sole proprietorship activities, theoretically to provide some equity and relief to non-corporate taxpayers in light of the reduction in corporate income tax rates.

Under Section 199A, eligible taxpayers may be entitled to a deduction of up to 20% of qualified business income (QBI) from a domestic business operated as a sole proprietorship or through a partnership, S-corporation, trust, or estate. For taxpayers with taxable income that exceeds $315,000 for a married couple filing a joint return, or $157,500 for all other taxpayers, the deduction is subject to limitations. These include disqualifying certain types of trade or business and calculations based on the amount of W-2 wages paid by the qualified trade or business and the unadjusted basis immediately after acquisition (UBIA) of qualified property held by the trade or business. Income earned through a C-corporation or by providing services as an employee is not eligible for the deduction (no deduction is allowed for the taxpayer's income from the trade or business of being an employee). The deduction is available regardless of whether an individual itemizes his or her deductions on Schedule A or takes the standard deduction.

The simplest application of this deduction is for taxpayers whose taxable income does not exceed a threshold of $315,000 (joint filers) or $157,500 (all other taxpayers). In this case, the deduction is generally the lesser of 20% of your QBI or 20% of taxable income. You are eligible for the deduction regardless of whether there are W-2 wages from the activity or you have a specified service trade or business. Once taxpayers reach taxable income exceeding the threshold amount by $100,000 for joint filers and $50,000 for all other filers, there is no deduction available for specified service trades or businesses.

Specified service trades or businesses include any trade or business involving the performance of services in one or more of the following fields: health, law, accounting, actuarial services, performing arts, consulting, athletics, financial and brokerage services, investment management, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners.

Once you are over the income thresholds noted above, the W-2 wage limitation phases in. The W-2 wage limitation is equal to the greater of: (i) 50% of the taxpayer's allocable share of the entities' W-2 wages paid; or (ii) the sum of (a) 25% of the W-2 wages allocated to the taxpayer plus (b) 2.5% of the unadjusted basis (immediately after acquisition) of all qualified property. It is anticipated that the information required to perform this calculation will be provided by the pass-through entity on the K-1 form.

QBI is the net amount of all "qualified items" of income, deduction, gain, and loss. If the taxpayer's net amount of QBI from all qualified trades or businesses during the tax year is a loss, it is carried forward as a loss from a qualified trade or business in the next tax year and reduces the taxpayer's deduction in a subsequent year (but not below zero) by 20% of any such carryover loss. If the taxpayer has multiple qualified trades or businesses, it is possible that they can be aggregated together as one under special rules.

A frequent question is whether the Section 199A applies to rental activities. The IRS recently issued proposed regulations to provide guidance on the definition of trade or business. Under various other regulations in the tax code, rental activity is not considered a trade or business, with some exceptions. This is true under Section 199A as well, but the criteria for evaluating whether the activity rises to the level of a trade or business under this regulation is different. For example, you need to determine whether the property is actively or non-actively managed. There also are some situations where common control exists and an election to aggregate activities can be made, allowing the rental activity to be included as QBI.

Section 199A has generated a lot of discussion because there are many criteria to consider when determining whether you may benefit from the new provision. Your filing status, adjusted gross income, and type and number of activities all need to be considered. Every situation is unique. We encourage you to contact us to discuss your specific situation.

Year-End Tax Planning for Businesses *(continued from previous page)*

The NOL rules have also been altered. For NOLs arising in tax years beginning January 1, 2018 or later, the two-year carryback option is no longer available and the NOL deduction is generally limited to 80% of taxable income. Taxpayers who have historically generated large business losses will want to monitor income and expenses carefully to avoid exceeding the limit, if possible.

The TCJA imposes a new limit on the amount of net business interest expense that can be deducted in any taxable year for taxpayers with average annual gross receipts greater than or equal to $25 million. Aggregation rules apply to related businesses. Business interest expense does not include investment interest expense or floor plan financing interest. Any business interest expense that is not deductible is carried forward indefinitely.

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Cash Method of Accounting and Accounting for Inventories Under the TCJA

By Evan Ramiza, CPA

One of the objectives of the Tax Cuts and Jobs Act (TCJA) was to simplify the tax code and provide relief for businesses, notably small businesses. While some of the changes in the new law have created increased complexities and uncertainties, some of the changes have created efficiencies, such as allowing for the use of the cash method of accounting for many more taxpayers. This change will simplify recordkeeping and reporting for taxpayers who migrate to this method of accounting.

Under the cash method of accounting, income and expenses are generally realized when cash is received or an expense is paid. This allows the tax return to potentially reflect more accurately a businessowner's understanding of the net income during the tax year and more closely follow the cash flow for the year. This contrasts with the accrual method of accounting, where income is generally realized when earned, even if payment is received in a later year, and expenses are realized when incurred even if payment is not made until a later year.

Under the TCJA, a small-business taxpayer is defined as a taxpayer that has average annual gross receipts for the three prior taxable years of $25 million or less. If you meet this criterion, you could elect to change from the accrual method of accounting to the cash method of accounting on your tax return for the tax years beginning after December 31, 2017.

Another change in the new law that will provide relief to businesses is the exemption from the requirement to account for inventories. Under the TCJA, a small-business taxpayer (as defined above) can choose to either 1) treat inventory as non-incidental materials and supplies, or 2) account for inventory using a method that conforms to their applicable (audited) financial statements. If they don't have applicable financial statements, they can use the accounting method used in their books and records.

By treating inventory as non-incidental materials and supplies, the small-business taxpayer would only be reporting the inventory value at the cost of the materials and would be able to deduct all of the labor and overhead costs associated with the purchase or production of the inventory items without having to capitalize those costs into inventory and wait until the inventory is sold or consumed to deduct the costs. Accrual basis taxpayers deduct the costs of non-incidental materials and supplies when they are consumed. Cash basis taxpayers deduct the costs when they are consumed or paid, whichever is later.

Small-business taxpayers also are no longer subject to uniform capitalization (UNICAP) rules that required inventory to reflect certain production-related direct and indirect costs for tax purposes. The application of these rules frequently resulted in a reduction in deductible expenses on the return.

If you wish to discuss a change to the cash method of accounting or treating inventory as non-incidental materials and supplies, please call our office to schedule an appointment.

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