GRANITE POINT TAX GROUP, LLC

Annual Newsletter, Vol. 8

License OBTP#15341

Any guesses what this year's newsletter will be about? That's right…we have plenty to talk about this year. We'll skip the big corporate stuff and provide a brief summary of changes created by the Tax Cuts and Jobs Act that will impact the average taxpayer. Note that unless specified, all these changes begin with 2018 tax returns.

Tax Rates and Brackets

For starters, most individual tax rates beginning in 2018 will be lower than in previous years and the range of income they apply to (the tax bracket) will be slightly larger. For example, the top tax rate will change from 39.6% on income of $470,701 (married filing jointly) to 37% on income above $600,000. The lowest rate remains unchanged at 10%, but applies to the first $19,050 instead of $18,650. There are significant tax rate reductions (3% and 4%) for the two brackets covering taxable income of $77,400 to $315,000 for joint filers.

Standard Deduction and Personal Exemptions

The standard deduction for all taxpayers will approximately double, from $12,700 (married filing jointly) to $24,000 and will be indexed for inflation after 2018. The elderly and blind will continue to receive a bonus deduction. Under these new thresholds, *far* fewer taxpayers will have enough mortgage interest, charitable deductions, etc. to itemize and will instead claim the standard deduction. For relatively simple tax returns, this

Office: 4710 SW Kelly Ave, 2nd Floor • Portland, OR 97239 – Mailing Address: PO Box 69007 • Portland, OR 97239 – Phone: 503-208-3736 – Fax: 503-894-9683

should ease the complexity of filing. The downside to this is that the personal exemption of $4,050 per household member has been completely eliminated. The net effect is that a household of three or fewer may enjoy a reduction in taxable income, while households of four or more will likely see the opposite. But before you get too worked up, though, be sure to read about the Child Tax Credit later.

Itemized Deductions

Big changes here, too. High incomers will be happy to know the “Pease limitation” on overall deductions has been repealed. Other than that, though, most changes here will benefit Uncle Sam. Interest on acquisition mortgages of a primary and secondary home is still deductible, but only on mortgages (incurred after 2017) up to $750,000 instead of $1 million. And interest on home equity loans and lines of credit is no longer deductible at all. Medical expenses go back to the old 7.5% AGI limitation, but only for 2017 and 2018 – after that they revert to a 10% AGI haircut. The deduction for state income and real estate taxes is now capped at $10,000 (note, this does not apply to rental or other business properties). Charitable contributions are still deductible and the limitation rises from 50% of AGI to 60%. Unfortunately, the deduction can no longer be claimed for the purchase of college athletic seating rights.

The deductions for personal casualty and theft losses are eliminated including losses from a home fire.

And finally, miscellaneous deductions – brokerage fees, employee business expenses, tax preparation fees, hobby expenses, fiduciary fees, union dues, and anything else that fell under the 2% AGI limitation – all gone. That entire section of Schedule A has been completely eliminated. We are still working to fully understand this ourselves, as it seems to override the longstanding tax principle that expenses incurred in the pursuit of taxable income are deductible. If you feel like this could impact you, please check back with us later in the year when we have hopefully refined our understanding of it.

AMT, Credits, Etc.

As predicted, the Alternative Minimum Tax remains on the books, but the exemption from it has increased and the phase-out of the exemption has increased significantly. The Child Tax Credit has increased to $2,000 per eligible child, no change to age restriction. And we have a new $500 credit for non-child dependents such as elderly parents. For divorce decrees entered after 12/31/18 alimony is no longer deductible by the payer, nor taxable to the recipient. The Kiddie Tax now taxes investment income of children at the much higher trusts rates instead of the parents’ rate. The deduction for job-related moving expenses now only applies to members of the military and tax free employer relocation expense reimbursements are gone. There will no longer be a penalty for not having health insurance, but other ACA provisions such as the 3.8% Net Investment Income Tax and the 0.9% Additional Medicare Tax remain in place.

Estates and Businesses

The estate tax exemption has doubled to $11.2 million. The top rate remains 40%. The gift tax exclusion is now $15,000 per recipient per year. And (thank goodness) we still have the step-up in basis for inherited assets.

The top corporate tax rate has dropped from 35% to 21% and the corporate AMT is eliminated. Owners of pass-through entities (sole proprietors, S-Corporations, partnerships, and LLCs) may benefit from an entirely new deduction. These businesses will receive a deduction of 20% of net qualified business income from their taxable income (does not reduce AGI). Qualified business income is generally self-employment income and not investment income like interest, dividends and capital gains even if earned as part of a trade or business. This deduction does not reduce the amount of self-employment income that would otherwise be due. The deduction is not available to engineering and architectural firms. High income owners of service industries (law, accounting, consulting, etc.) may not be so lucky, as the deduction does have phase-outs. On a joint return the phase outs start at $315,000 of taxable income, $157,500 for individual filers.

Section 179 has doubled, now allowing up to $1 million of asset purchases to be deducted in the year of purchase. And Bonus Depreciation has also been expanded to 100% of the cost of first-use assets until 2022, then phasing back down after that.

Overall business losses are now capped at $500,000 per year, with any excess carrying forward. And Net Operating Losses are limited to 80% of income and can no longer be carried back except in the case of certain farmers.

Other changes affecting businesses: Interest expense deduction is limited to 30% of net income, business meals are still 50% deductible but entertainment expenses are axed, the Domestic Production Deduction is eliminated, and tax-deferred like-kind exchanges only apply to real estate. Meals provided to employees are now subject to the 50% limitation. And there is a new credit for the next two years for up to 12.5% of the wages paid to employees during medical leave (many exceptions and restrictions apply). Luxury auto deductions limits are substantially increased. There are *many* more business provisions, far too many to list here.

So what's the bottom line?

How will this affect me?

We know that what you really want to know is how this will impact you. Heck, it's the same question on our minds! But to be honest, this tax package is so comprehensive and so complicated that we really do not know how this will all play out – there are just too many moving parts. And since we won't have 2018 tax software until this time next year, we expect this will be a turbulent year with many unanswered questions. Our apologies in advance, we'll do our best! In particular, those clients who make quarterly estimated tax payments may need to "roll with the punches" as we forge our way into uncharted waters.

Here are a few planning ideas that have emerged in the available commentary. We have to look carefully at the type of business entity used for your business focusing particularly on whether remaining an S-Corp or maintaining an S-Corp election is still beneficial if the new 20% deduction does not applying to officer wages. Charities are going to suffer from the loss of contributions if many taxpayers stop itemizing deductions. Using the IRA charitable donation rules is a way to still obtain a tax benefit from donations. Using HSA accounts if possible will allow the deduction of medical expenses if they are otherwise not deductible.

All the tax law changes that apply to individuals expire in 2025. Only the reduced corporate tax rates and other provisions that benefit large corporations are permanent. It would not surprise us if significant adjustments are made to the new rules as their impact on taxpayers becomes better understood. IRS also has the very difficult task of working the new rules into their forms and instructions. This process involves a great deal of interpretation on their part which can impact how the new laws are actually applied. Where the law creates ambiguity and creates conflicting interpretations of the tax code (we see potential for this already) we end up with uncertainty regarding the correct position to take on a particular reporting issue. Regardless of the bill's intended benefits and the winners and losers it deliberately picks, we see the potential for many unforeseen consequences. It is hard not to conclude that both our jobs as tax preparers and your compliance burden just got a lot harder!

A Reminder – No Cell Phone Photos!

Please refrain from e-mailing cell phone photos of tax documents. Besides the obvious security issue, it is extremely difficult on our end to convert them to useable paper documents for our files. If this is the only feasible method available to you, please consider using an app that acts as a scanner and follow their instructions regarding resolution, framing, photo angle, lighting, etc. Thank you!

Thank You

Thank you so much for seven years (and counting!) of trust and patronage. It means a great deal to us that we can provide our families with a healthy balance between income and time spent together. It wouldn't happen without you!