Granite Point Tax Group, LLC

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You like change, right? That's good, because we're in for a lot of it this year! New rules, new forms, new schedules, and as of this writing no federal government. What does it all mean? We'll take a look at each subject in detail, but the ultimate takeaway is that we expect a turbulent and challenging tax season. But, if we all work together we will get through it just fine.

Government Shutdown

At the time of this writing, the federal government is currently closed with no set date for re-opening. This has a significant impact on the IRS; according to our understanding only 12% of IRS employees are reporting for duty, and unpaid at that. We've yet to see an announcement from IRS describing the impact this may have, but it seems safe to assume that taxpayer services will be hit hard. They just announced they plan to begin accepting e-filed tax returns on January 29. As far as we know the filing deadline is still April 15, so as you can imagine there will be quite a rush to file returns once the season begins. For small firms like ours, this means more clients are likely to go on extension to be filed after April 15. More on that later.

Tax Cuts and Jobs Act

We covered this in some detail in last year's newsletter, but to recap the highlights:

- Tax rates are generally about 2% lower and the brackets are wider.
- Standard deductions have approximately doubled, so fewer folks will itemize deductions under the new rules. Note, however, that many will continue to itemize for their *state* tax return!
- For taxpayers that do itemize, the deduction for state and local taxes is limited to $10,000 and the mortgage interest deduction is limited for new mortgages. The miscellaneous itemized deduction category has also been

completely eliminated. This includes unreimbursed employee expenses, investor adviser fees, and tax prep fees, among others.

- Personal exemption deductions have been eliminated.
- AMT, phase-outs, etc. have been eliminated or significantly adjusted and should impact far fewer taxpayers.
- The Child Tax Credit has doubled and we have a new $500 credit for non-child dependents.
- Alimony is not taxable or deductible for divorce decrees entered after 12/31/18.
- Kiddie Tax is now calculated using Trust tax rates instead of the parents' tax rate.
- Moving expenses are no longer deductible or tax-free except for active military members.
- Starting 1/1/19, no ACA penalty for lack of health insurance. Other ACA tax provisions remain in place.
- Estates up to $11.2 million exempt from federal estate tax. Annual gift tax exclusion is now $15,000/recipient.
- Section 179 depreciation limit has doubled to $1 million. Bonus depreciation has also doubled to 100%.
- Pass-through entities (sole proprietors, partnerships, S-Corps, most LLCs) may qualify for 20% net income deduction. Numerous rules and restrictions apply.
- Domestic Production Activities Deduction has been eliminated.
- Net Operating Losses no longer carry back, only forward, and can only offset up to 80% of current income.
- Business-related entertainment expenses are no longer deductible. Meals remain 50% deductible.
- Capital gains tax rates stay pretty much the same.
- Tax deferred exchanges have been eliminated except for real estate 1031 exchanges.
- Casualty and theft loss deductions have been eliminated.

There are many, many changes made by the new tax law so we cannot summarize all of them. These are just the most significant and the most likely to apply to our clients. More details on some of these changes are provided below.

New Forms and Schedules

Remember about a year ago we were told we'd all be filing tax returns on a postcard soon? Well…in what can only be described as government following orders and marching straight off a cliff, the IRS has reduced many tax forms, most notably Form 1040, to half-page format. But since we are required to report all the same information, they essentially just increased the number of pages of the tax return by creating a slew of new schedules supporting the new form. Schedules 1 through 6 (all in half-page format) will now be used to report information that used to fit on the two pages of Form 1040. Schedules A-J and their supporting forms are the same full-page format as before. Form 1040 itself has a new look and Forms 1040-EZ and 1040-A have been eliminated. Ugh!

The New QBI Deduction

This new deduction for businesses is probably the most interesting and beneficial part of the new tax law. It allows certain businesses to deduct 20% of their net business income from taxable income. It does not reduce self-employment or any other taxes, just income tax. The beneficiaries of this deduction are Schedule C filers and pass-through entities (partnerships, LLCs and S-corps). There are complex limitations for higher income taxpayers, but it looks like most of our business clients will benefit significantly from this deduction.

Affordable Care Act Mandate and Penalties

Starting in 2019 the requirement to have insurance and the enforcement penalties associated with it have been eliminated. We still have to compute the penalty or report an exemption for those lacking insurance in 2018.

Qualified Opportunity Zones

Capital gains may now be deferred, and in some cases reduced, if proceeds are invested in a Qualified Opportunity Fund within 180 days of sale. A QOF is a new type of fund that invests in Qualified Opportunity Zones, which are also new. This is a very complicated set of rules, but appears to have tremendous tax planning implications. Early adoption of this benefit may be hampered by a lack of available funds to invest in, but we expect this new provision to become very popular in the coming years.

529 Savings Plans Modified

You can now take money from these plans tax-free to pay for elementary and secondary school tuition as well as secondary education expenses. But, see the section on Oregon changes below.

New Vehicle Limits

Using the new 100% bonus depreciation, buyers of SUVs with a gross vehicle weight of over 6000lbs used for business can deduction 100% of the cost. This also applies to heavy pickup trucks with a cargo bed of at least six feet. These rules now apply to new or used vehicle purchases. Luxury car depreciation limits have also been raised.

Accounting Method Changes

This is getting into the minutia of the accounting world, but is actually a pretty big deal for business clients with high gross income. Under the new rules we have a very high gross income test ($25 million three year average) before the requirements to report on the accrual method kicks in. So, for all practical purposes, none of our business clients will need to worry about changing from the cash method of accounting to accrual.

Meals and Entertainment Expenses

Under our new tax law the deductibility of entertainment costs (eg. tickets to a sports game for a client) as a business expense has basically been eliminated. This has created some grey areas for the deductibility of meals, but we believe most meal expenses are still deductible, after applying the old 50% limit.

Mortgage Interest Deduction

Changes to this deduction apply to mortgages originating after 12/15/2017. The deduction for equity lines of credit has been eliminated unless the loan is used to pay for improvements. Interest on regular acquisition debt remains deductible for total debt up to $750,000.

4710 SW Kelly Ave, 2nd Floor Portland, OR 97239 – Phone: 503-208-3736- Fax: 503-894-9683

Sales Tax Changes

On the business side, we also have major changes coming to the way state sales taxes are applied to inter-state product and service sales. This summer the US Supreme Court overturned a long-standing rule requiring a seller to have physical presence in a state before the state could impose a sales tax on its activity. States are now, within limits, free to craft their own rules to determine when they may impose their sales tax on out-of-state sellers. Any business engaging in significant cross-border sales to states that have a sales tax should pay special attention to the new rules emerging on this issue.

Filing Extensions Explained

With the many challenges we will face this tax season we may find that there is not enough time to file our usual amount of returns before the April 15 deadline. If this happens, we will need to rely upon extension filings to ensure all clients' returns are filed correctly. Here is some information that will hopefully allay any fears you may have about extensions. They are, in truth, a very useful tool for both taxpayers and tax preparers alike.

Although the tax deadline is April 15, all taxpayers (except those few who have an agreement with IRS to *not* file for an extension) can request a six-month extension to file their tax return. This is done by filing Form 4868 or submitting an online payment to IRS and designating the payment toward Form 4868. There is no fee for filing the extension and in nearly all cases the request is granted automatic approval. The catch is that the extension is for filing the tax return, NOT for sending any money due; any tax due is due by April 15 regardless of when you actually file your tax return. Amounts not paid by April 15 will incur late payment penalties.

From a practical standpoint this means all tax returns, even those going on extension, need to be at least roughly worked up in order to determine whether taxes are due and approximately how much. This takes away time we would otherwise be finishing and filing tax returns, so for us the timeframe for actually filing tax returns runs from about early February through late March. At that point we are forced to work on extensions right up until the deadline. We then spend the next six months finishing and filing all the returns that went on extension – hopefully with little or no balances due.

Many clients who have never gone on extension before have some reservations about the idea at first, worrying that it will somehow affect their risk of audit or cause other problems. None of these are true – extensions do not cost anything, do not increase your audit risk, and do not put you in the government's crosshairs in any other way. We prepare and file a great many extensions each year, including for our own tax returns! The one true downside to the process is that the IRS will not issue a refund until the actual tax return is filed. For this reason we do our best to prioritize the filing of returns with substantial refunds due; if this is a concern to you, please let us know well in advance so we can complete and file your return before April 15 or shortly thereafter (on extension).

News for Estates and Trusts

The federal estate tax exemption amount and filing requirement remains very high at over $11 million in assets so our primary focus is on Oregon taxable estates whose exemption amount is just $1 million. Life-time gifting is still a viable tool to bring estates below the exemption amount and avoid the Oregon filing. The annual gift tax exclusion amount rose to $15,000 for 2018.

The new tax act also impacts the *income* tax returns we file for estates and trusts. For these returns, which are reported on Form 1041, the new rules have eliminated the deduction of expenses falling within the miscellaneous itemized deduction category. IRS has indicated that it will still accept deductions for estate and trust administration expenses, like attorney, accountant and fiduciary fees. Investment adviser fees and property maintenance expenses are, however, no longer deductible. We will probably be adding property maintenance expenses to the basis of property held by an estate or trust for sale so we get some use out of them. The use of excess deductions passed out to beneficiaries in the final year of administration is now in question as the place we used to take this deduction on form 1040 is now gone.

Oregon Tax Law Changes

Oregon is accepting most of the new federal law adjustments to taxable income. It has decided not to accept the tuition 529 plan adjustments that allow the payment of K-12 tuition. Taxpayers that use these new provisions will have an adjustment on their Oregon returns. Oregon recently added a new lower tax rate for certain businesses, similar to the federal QBI deduction, and for 2018 decided to make this benefit available to Schedule C filers. This may help many of our small business clients pay less Oregon tax.

So what's the bottom line? How will this affect me?

Our best guess – tax season will start a little later, take a little longer, and in some cases cost a little more. Business returns (including sole proprietorships) in particular will be more challenging this year as we navigate the new pass-through deduction. We anticipate more returns than usual will be filed after April 15 (March 15 for partnerships and S-Corps) on extension.

Cell Phone Photos of Tax Documents

Sending us photographs of documents may seem like a good idea, but in practice documents received this way are very difficult for us to work with and may increase the time (and therefore the cost) spent on your tax return. If you must send pictures of documents, please observe the following guidelines:

- Ensure the document is flattened – photos of partially folded papers are very difficult to read.
- Align the camera properly – Photo should be straight down, not at an angle.
- Ensure readability – Please LOOK at your photo to ensure it is legible before sending it to us!
- Include the entire document – Be sure the photo captures the entire page. Also be sure to check for relevant information on the *back* of each page.
- Please DO NOT e-mail tax documents. E-mail is generally not secure. Please use our file portal.
- If all this seems like too much work, please just mail us the originals – it's what we'd prefer anyway. Don't worry, we'll send them back to you when we're done with them.

Thank You

Thank you so much for your many years of trust and patronage. We feel like we have created a special work place made more so by the many clients we enjoy seeing year after year. Thank you!

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