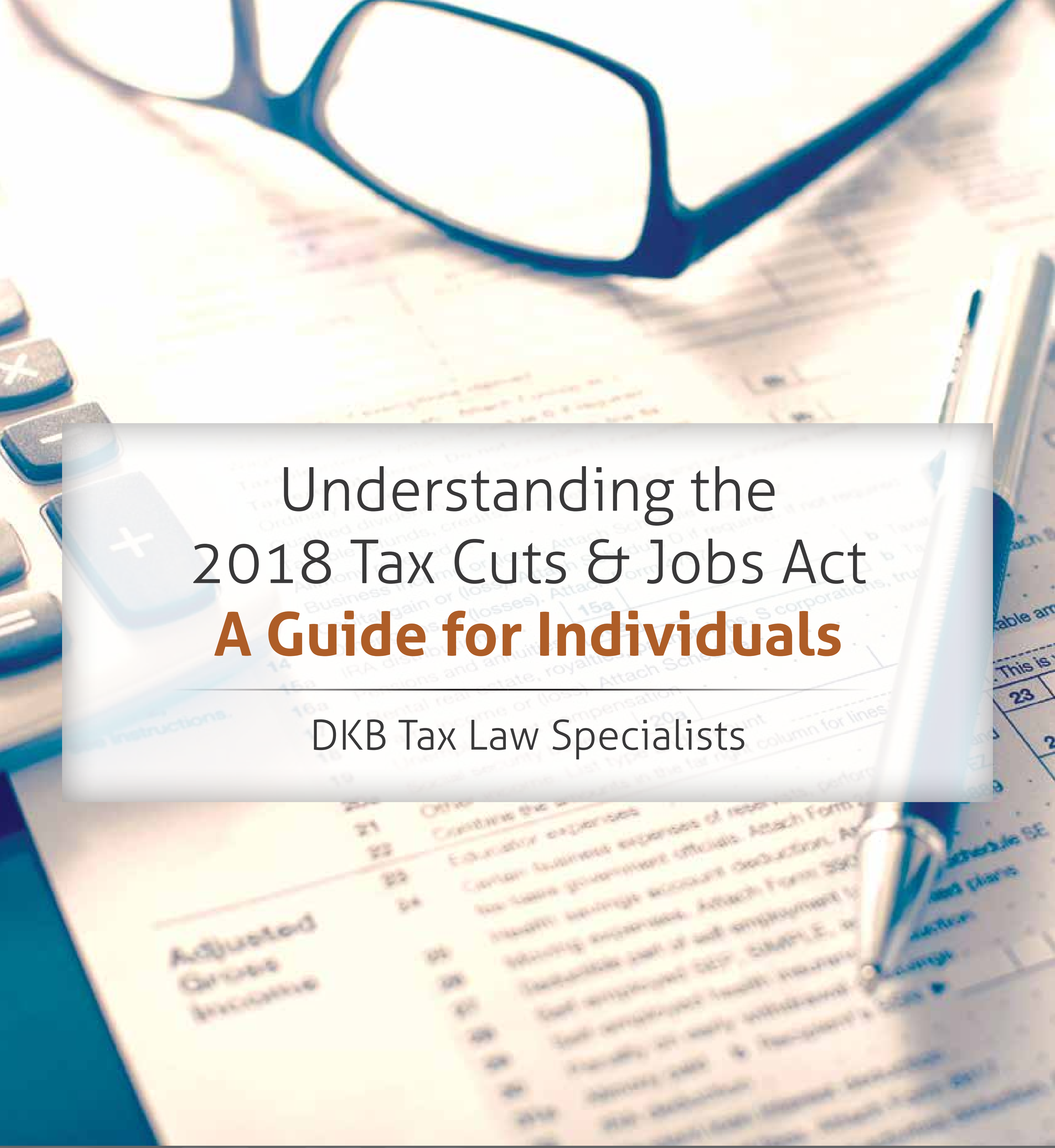

Understanding the 2018 Tax Cuts & Jobs Act

A Guide for Individuals

DKB Tax Law Specialists

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Business Advisors & CPAs

2018 TAX CUTS & JOBS ACT

President Trump has signed the Tax Cuts & Jobs Act and it's no longer just a bill, it's the law. It features reduced tax rates, an increase in the child tax credit and even higher standard deductions. Plus, personal tax brackets and rates are improved.

But, we have to pay for these tax breaks somehow. In order to do this, Congress took away many deductions that millions of taxpayers had used every year to reduce their tax bills. The following provides an overview of the key changes of the 2018 Tax Cuts & Jobs Act that are going away that will affect most individual taxpayers in some form or fashion.

TAX RATES and INFLATION

TAX RATES

The main feature of the 2018 Tax Cuts & Jobs Act is that the top individual tax rate will drop to 37 percent. The new tax law also cuts income tax rates, doubles the standard deduction and eliminates personal exemptions. And while corporate cuts are permanent, the individual changes expire at the end of 2025.

INDIVIDUAL TAX RATES – SINGLE

2017 Tax Year Single Filers		2018 Tax Year (New Tax Bill) Single Filers	
10%	$0 - $9,325	10%	$0 - $9,525
15%	$9,326 - $37,950	12%	$9,526 - $38,700
25%	$37,951 - $91,900	22%	$38,701 - $82,500
28%	$91,901 - $191,650	24%	$82,501 - $157,500
33%	$191,651 – $416,700	32%	$157,501 - $200,000
35%	$416,701 - $418,400	35%	$200,001 - $500,000
39.6%	$418,401 +	37%	$500,001 +

INDIVIDUAL TAX RATES – MFJ

2017 Tax Year MFJ Filers		2018 Tax Year (New Tax Bill) MFJ Filers	
10%	$0 - $18,650	10%	$0 - $19,050
15%	$18,651 - $75,900	12%	$19,051 - $77,400
25%	$75,901 – 153,100	22%	$77,401 - $165,000
28%	$153,101 - $233,350	24%	$165,001 - $315,000
33%	$233,351 - $416,700	32%	$315,001 - $400,000
35%	$416,701 - $470,700	35%	$400,001 - $600,000
39.6%	$470,701 +	37%	$600,001 +

INFLATION

This will be the cause for the biggest long-term change for taxpayers in the bill, resulting in a tax increase years after the 2018 tax cuts expire.

The inflation measure used for certain income thresholds in 2017 and before was the Consumer Price Index. Moving forward into 2018, inflation will be measured by Chained CPI (C-CPI), which is a less-generous measure.

STANDARD DEDUCTION

In 2017, individual taxpayers were able to reduce their taxable income by $4,050 per dependent with the personal exemption. The 2018 Tax Cuts & Jobs Act takes away these personal exemptions.

However, the personal exemption simply became a part of the standard deduction, which was increased. Depending on the number of dependents you have, the increase in the standard deduction won't be enough to compensate for the loss of personal exemptions.

All individual itemized deductions are eliminated except for:

- Mortgage Interest ($750,000 limit)
- State Income & Real Estate Taxes ($10,000 limit)
- Charitable Contributions
- Investment Interest Expense
- Medical Expenses

Non-itemized deduction remaining:

- Student Loan Interest

OTHER DEDUCTIONS

MORTGAGE INTEREST DEDUCTION

The mortgage interest deduction is now limited to the first $750k of debt taken out after 12/15/17 on primary and second homes.

HOME EQUITY LOAN INTEREST DEDUCTION

Beginning in 2018, the interest on home equity loans (HELOC) are no longer deductible. To make matters worse, no grandfathering in for existing HELOCs. Taxpayers should measure this effect and consider consolidation with your mortgage or paying this down. It's important to remember that, with the tracing rules, if you used the HELOC for business purposes, it could still potentially be deductible. That being said, if you used the HELOC for personal purposes, it's non-deductible beginning January 1, 2018.

ALIMONY PAYMENT DEDUCTION

Although not effective until January 1, 2019, you can expect to see a last-minute rush to divorce court and an increase in settlements in 2018. Prior to the 2018 Tax Cuts & Jobs Act, alimony payments were separate from maintenance and child support, and were deductible by the paying ex-spouse, while the receiving ex-spouse had to include it in taxable income. Under the new law, these payments are no longer deductible or includible. Agreements in place prior to January 1, 2019 are not affected by the new law.

Pre-nuptial and post-nuptial agreements may want to be reviewed as many were put in place assuming the alimony tax deduction was available.

CHILD TAX **CREDIT**

HOW MUCH IS THE CREDIT?

The maximum child tax credit topped out at $1,000 per child through December 25, 2017. The 2018 Tax Cuts & Jobs Act increases the credit to up to $2,000 per child, but this doesn't necessarily mean that all qualifying taxpayers will receive this much. Certain terms and conditions can whittle away at these caps in both years.

YOU MUST HAVE AT LEAST ONE QUALIFYING CHILD

One aspect of the Child Tax Credit hasn't changed: you must have a qualifying child dependent and the rules for exactly who qualifies are somewhat intricate. The child can't have turned 17 by the last day of the tax year, and they must be related to you. However, the definition of 'related' in this case is broader than you might expect. The list of qualifying children includes: biological and adopted children, stepchildren, foster children living in your care, siblings, stepsiblings, or a child of any of these individuals.

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KIDDIE TAX

This tax continues to apply to annual unearned income (above $2100 in 2018). In the past, earnings subject to the kiddie tax were taxed at the parents' tax rate. Starting with 2018 returns, the parents' rate won't matter. Instead, investment earnings in excess of $2,100 – received by a child under the age of 19 or full-time student under the age of 24 – will be taxed at the rates that apply to trusts and estates. Here are those rates for 2018:

Up to $2,550 – 10%

$2,550 to $9,150 – 24%

$9,150 to $12,500 – 35%

Over $12,500 – 37%

Note that under the new individual income tax brackets, the top 37% rate doesn't kick-in for individual taxpayers until taxable income exceeds $500,000. At first glance, it might appear that the severely compressed rate structure that tops out at $12,500 will trigger bigger tax bills than in the past. But that's not necessarily the case. It depends on the amount of income subject to the kiddie tax and the parents' tax bracket.

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529 PLANS

The 2018 Tax Cuts and Jobs Act made an amendment to the existing Section 529 of the Internal Revenue Code – the provision that created college savings plans and is where the popular 529 Plan name came from. The new law now includes Section 529(c)(7), which adds to the definition of "qualified higher education expense" any expenses paid for tuition "in connection with enrollment or attendance at an elementary or secondary public, private, or religious school."

In practical terms, what this means is that funds are now available for tuition for those in Kindergarten through 12th grade. For example, if a child goes to school at an institution that charges tuition, you can take distributions from a 529 Plan to pay it, and any earnings from those distributions will be fully tax-free – just as they would be if you'd used the money for permitted college expenses.

Distributions of up to $10,000 may be used for "qualified expenses" for elementary school and high school. However, tuition for colleges and universities remains in effect.

ALTERNATIVE MINIMUM TAX (AMT)

The AMT is a separate tax system that resembles our "more-familiar" regular federal income tax system. The difference is that the AMT system taxes certain types of income that are tax-free under the regular tax system and disallows some regular tax breaks.

The maximum AMT rate is "only" 28% – versus the 39.6% maximum rate that applied under the prior law, and the 37% regular tax maximum rate that applies for 2018-2025 under the new law.

In order to ensure that the AMT primarily affects its intended targets (high-income households) from 2018 on, the Tax Cuts & Jobs Act significantly increases the AMT exemption amounts and dramatically raises the phase-out thresholds for these exemptions. It also permanently indexes the exemptions for inflation going forward. In addition, the AMT rules are now more taxpayer-friendly, with other changes reducing the odds that you'll owe the AMT for 2018-2025.

Bottom line: with the exemption threshold increased significantly, you'd need a very unique set of circumstances to qualify for the AMT.

ALTERNATIVE MINIMUM TAX (AMT)

	2017 Tax Year - MFJ	2018 Tax Year (New Tax Bill) - MFJ
Single or HOH	$54,300	$70,300
Phase-out – Single or HOH	$120,700	$500,000
MFJ	$84,500	$109,400
Phase-out - MFJ	$160,900	$1,000,000

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ESTATE PLANNING

The 2018 Tax Cuts & Jobs Act presents a unique opportunity for timing your estate planning.

The cumulative amount of transfers exempt from both federal gift and estate taxes (the federal exemption amount) is doubled from $5 million per person to $10 million per person. While the transfer tax exemptions continue to be indexed for inflation, it will be done by a different measure (Chained CPI) that results in a smaller inflation adjustment than under prior law. For 2018, the exemption available to each individual under the new indexing is $11,180,000, allowing a married couple to transfer up to $22,360,000 free of the federal gift and estate tax.

As was the case under prior law, to the extent an individual uses his or her federal gift tax exemption during life, it will reduce the exemption available for federal estate tax purposes. The amount exempt from the federal generation-skipping transfer (GST) tax in 2018 also is $11,180,000 and will also be indexed for inflation in subsequent years. The federal estate, gift, and GST tax rate remains at 40 percent. The increased exemption amounts sunset at the end of 2025, reverting back to $5 million, indexed for inflation.

For New York State residents, there's a benefit to gifting during life. While Basis step-up for inherited assets remains.

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RETIREMENT PLANNING

The Tax Cuts & Jobs Act modifies some provisions related to retirement plans and IRAs. These include:

- The repeal of the special rule permitting re-characterization of Roth IRA conversions
- An increase in the period during which a qualified plan loan offset amount may be rolled over
- Relief for qualified 2016 disaster distributions
- An increase in allowable amount of length-of-service awards

However, even with all of the hype leading up to tax reform, retirement planning was left mostly alone. The major change is the ability to characterize any Roth IRA conversion has been removed for 2018 onward.

Re-Characterization of Roth IRA Contributions

Under the prior tax code, an individual who made contributions to a Roth or traditional IRA could subsequently decide that a contribution to an IRA of the other type is more advantageous. If certain requirements were met, a contribution could be characterized and treated as having been originally made to a different type of IRA. Re-characterizing an IRA contribution required transferring amounts previously contributed to a traditional or Roth IRA (plus any resulting net income or minus any resulting net loss) to another IRA of the opposite type and electing to have the amounts treated as having been transferred to the second IRA at the time they actually were contributed to the first IRA.

Now, the ability to re-characterize a Roth conversion to a traditional IRA is removed after 2017* with an extension of the rollover period for plan-loan offsets.

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*You can still re-characterize your 2017 Roth conversions until 10/15/2018.

FIFO

According to the previous tax code, sellers of stock in any one company would've been required to dispose of shares in the order they were acquired. Sellers can no longer designate which blocks of their shares they wished to sell to minimize capital gains taxes.

The original Senate FIFO provision would have had a huge impact on long term investors, creating a large effective increase in capital gains tax rates. However, the Senate's FIFO provision was removed from the final tax bill.

LAST CHANCE FOR **2017** DEDUCTIONS

If you have any of these deductions, get them in on the 2017 income tax return. Get those property taxes paid and your 2017 state income taxes if applicable. The rates are going down, but so are the available deductions.

ABOUT **DKB**

DKB is a Certified Public Accounting firm headquartered in Rochester, NY. We have a unique service philosophy where being a trusted business advisor to our clients is of critical importance to us. We believe our job really begins when the tax return or audit ends. To us, client service involves constant, year-round communication so we can implement creative business ideas and strategies.

DKB is the hallmark of how we operate, always as a team, with one another, and with our clients. Over the past 26 years we have earned a loyal and satisfied client base, who are not only pleased will the level of service we provide, but who truly enjoy the professional relationships we have established with them.

It is important to understand that our focus is on providing our clients with unbiased, objective and useful advice. This places us in a position to deliver a consistent approach between all practice areas in our firm. Due to our strong belief in this philosophy, we do not sell any products, nor do we accept commission for referrals.

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