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2018 YEAR-END PLANNING GUIDE WITH TAX REFORM CONSIDERATIONS

As 2018 comes to a close, we are wrapping up another year of major tax changes. Due to the sweeping federal tax reform passed in 2017, known as the Tax Cuts and Jobs Act (TCJA), the U.S. tax system has changed significantly for both individuals and businesses. Navigating the new changes to implement tax strategies can be difficult because we are still awaiting guidance on some of the provisions from the TCJA. Below, we've provided a detailed look at a few of the most impactful measures resulting from the tax reform that you can take action on now as you begin your year-end planning.

INDIVIDUALS

- **New income tax rates and brackets:** For tax years 2018 through 2025, there are new tax brackets for individuals and estates.

Tax Rate	Joint or Surviving Spouse	Single	Head of Household	Married Filing Separately	Estates and Trusts
10%	$0-$19,050	$0-$9,525	$0-$13,600	$0-$9,525	$0-$2,550
12%	$19,051-$77,400	$9,526-$38,700	$13,601-$51,800	$9,526-$38,700	
22%	$77,401-$165,000	$38,701-$82,500	$51,801-$82,500	$38,701-$82,500	
24%	$165,001-$315,000	$82,501-$157,500	$82,501-$157,500	$82,501-$157,500	$2,550-$9,150
32%	$315,001-$400,000	$157,501-$200,000	$157,501-$200,000	$157,501-$200,000	
35%	$400,001-$600,000	$200,001-$500,000	$200,001-$500,000	$200,001-$300,000	$9,150-$12,500
37%	Over $600,000	Over $500,000	Over $500,000	Over $300,000	Over $12,500

- **Standard Deduction Increased:** One of the most significant changes for individuals is the near doubling of the standard deduction. For tax years beginning after December 31, 2017 and before January 1, 2026, the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head of household and $12,000 for all other taxpayers. These amounts will be adjusted for inflation in tax years beginning after 2018.
- **Suspension of Personal Exemption:** For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for personal exemptions is effectively suspended.
- **Modification of the Kiddie Tax:** For tax years beginning after December 31, 2017, the tax on certain children with unearned income (the "Kiddie" tax) is imposed as follows: the child's taxable income attributable to earned income is taxed under the rates for single individuals. The child's

taxable income attributable to net unearned income (interest, dividends, capital gains) is taxed according to the brackets applicable to trusts and estates.

- **Increased Child Tax Credit:** For tax years beginning after December 31, 2017 and before January 1, 2026, the child tax credit is increased to $2,000 per child. This credit will phase out at $400,000 for married taxpayers filing jointly and $200,000 for all other taxpayers. The amount of the credit that is refundable is increased to $1,400 per qualifying child. No credit will be allowed with respect to a qualifying child unless the taxpayer provides the child's valid Social Security number.
- **State and Local Taxes Paid Deduction:** The itemized deduction for state and local income or property taxes will be capped at $10,000 for tax years 2018 – 2026.
- **Mortgage Interest Deduction Limitation:** For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for home mortgage interest is limited to interest on up to $750,000 ($375,000 for married taxpayers filing separately) of acquisition indebtedness and the deduction for interest on home equity indebtedness is suspended. The new lower limit does not apply to acquisition indebtedness incurred before December 15, 2017.
- **Individual Charitable Contribution Deduction Limitation Increased:** For contributions made in tax years beginning after December 31, 2017 and before January 1, 2026, the 50% limitation for an individual's cash contributions to public charities and certain private foundations is increased to 60%. Contributions exceeding the 60% limitation are generally allowed to be carried forward and deducted for up to five years, subject to the latter year's ceiling.
- **No Deduction for Amounts Paid for College Athletic Seating Rights:** For contributions made in tax years beginning after December 31, 2017, No charitable deduction is allowed for any payment to an institution of higher education in exchange for which the payer received the right to purchase tickets or seating at an athletic event.
- **Alimony Deduction:** For any divorce or separation agreement executed after December 31, 2018, (or executed on or before December 31, 2018, but modified later if the modification expressly provides that the TCJA rules apply), alimony or separation maintenance payments are not deductible by the payer spouse and are not included in the income of the payee spouse.
- **Suspension of Miscellaneous Itemized Deductions:** For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for miscellaneous itemized deductions that are subject to the 2% of AGI floor is suspended. Such deductions include but are not limited to tax preparation fees, safe deposit box rentals, investment management fees, unreimbursed employee business expenses and hobby losses.
- **Overall Limitation on Itemized Deductions ("PEASE limitation"):** For tax years beginning after December 31, 2017 and before January 1, 2026, the "PEASE limitation" on overall itemized deductions (also referred to as the 3%/80% rule) is suspended.
- **Excess Business Loss Limitation:** A taxpayer will only be allowed to deduct up to $250,000 ($500,000 for joint filers) of "excess business losses" for the taxable years between December 31, 2017 and January 1, 2026. Any business losses in excess of the limits will be disallowed and will be added to the taxpayer's Net Operating Loss (NOL) carryforward. This limitation will apply after the application of the passive loss rules.

- **Deduction for personal casualty and theft losses suspended:** For tax years beginning after December 31, 2017 and before January 1, 2026, the personal casualty and theft loss deduction is suspended, except for personal casualty losses incurred in a federally-declared disaster area, such as Hurricanes Michael and Florence.
- **Repeal of ACA Individual Mandate:** Under pre-TCJA law, the Affordable Care Act required individuals who were not covered by a health plan that provided at least minimum essential coverage to pay a “shared responsibility payment’, also referred to as a penalty, with their federal income tax return for any month the individual did not have minimum essential coverage. The TCJA permanently removes the individual mandate by providing for months beginning after December 31, 2018, the amount of the individual shared responsibility payment is reduced to zero.
- **Individual AMT Retained With Higher AMT Exemption Amounts:** For tax years beginning after December 31, 2017 and before January 1, 2026 the TCJA increases the amount of an individual’s alternative minimum taxable income that is exempt from AMT as follows:
    - For joint returns and surviving spouses, the AMT exemption will be $109,400.
    - For single taxpayers, the AMT exemption will be $70,300.
    - For married taxpayers filing separately, the AMT exemption will be $54,700.

  With the increased exemption amounts, the suspension of miscellaneous itemized deductions and the cap on state income taxes, far fewer individuals will be subject to the AMT.
- **Expanded Use of 529 Accounts:** For distributions after December 31, 2017, taxpayers can take a distribution of up to $10,000 from a 529 account to pay for elementary or secondary private school tuition.
- **Section 199A:** This is a new deduction for small business owners based upon Qualified Business Income (QBI). For tax years beginning in 2018 – 2025, the deduction can be up to 20% of a pass-through entity owner’s QBI and is subject to restrictions that can apply at higher income levels and another restriction based upon the owner’s taxable income.
    - For the pass-through entity deduction, pass-through entities are defined as sole proprietorships, single-member LLCs, partnerships, LLCs that are treated as partnerships and S corporations. The pass-through entity deduction is only available to noncorporate taxpayers (individuals, estates and trusts).
    - Certain trades or businesses are not included in the definition of a qualified businesses for the purpose of the pass-through entity deduction. Such excluded businesses are considered specified service trades or businesses (SSTBs). SSTBs include any trade or business involving the performance of services in the fields of health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services and any business in which the principal asset is the reputation or skill of one or more of its employees or owners.

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BUSINESSES

- **Corporate Tax Rates Reduced:** For tax years beginning after December 31, 2017, the corporate tax rate is a reduced to a flat 21%.
- **Personal Service Corporations (PSCs):** Previously, PSCs have been denied the lower corporate tax brackets and were taxed at a flat 35%. After the passing of the TCJA, PSCs will now be taxed at the same rate as other C corporations at 21%.
- **Dividends Received Deduction Percentages Reduced:** For tax years beginning after December 31, 2017, the 70% dividends received deduction is reduced to 50% and the 80% dividends received a deduction for 20% or more owned corporations are reduced to 65%.
- **Corporate Alternative Minimum Tax:** Corporate AMT was repealed altogether for tax years beginning after December 31, 2017. For tax years beginning after 2017 and before 2022, the AMT credit is refundable and can be used to offset regular tax liability in an amount equal to 50% of the excess credit for the taxable year.
- **Federal Research Credit:** The elimination of corporate AMT means that companies that were previously unable to use the Research Credit to offset their AMT can now reap the benefits of the credit by offsetting any current regular income tax or by carrying the credit forward for up to 20 years.
- **Increased Code Section 179 Expensing:** For property placed in service in tax years beginning after December 31, 2017, the maximum amount of Section 179 expensing available is $1 million, and the phase-out threshold is $2.5 million. For tax years beginning after 2018, these amounts are indexed for inflation. The definition of qualified real property under Code Section 179 was expanded to include certain improvements to nonresidential real property, such as roofs; heating, ventilation and air conditioning property; fire protection and alarm systems; and security systems.
- **100% Bonus Depreciation:** For certain assets placed in service after September 27, 2017 and before January 1, 2023, taxpayers can claim a 100% first-year deduction for the adjusted basis of the property acquired.
- **Luxury Automobile Depreciation Limits Increased:** For passenger automobiles placed in service after December 31, 2017, for which the additional first-year depreciation is not claimed, the maximum amount of allowable depreciation is increased to $10,000 for the year the vehicle is placed in service; $16,000 for the second year; $9,600 for the third year; and $5,760 for the fourth and later years.
- **Business Interest Expense Deduction:** For taxable years beginning in 2018, every business, regardless of its form, with average annual gross receipts in excess of $25 million, is generally subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. The business interest limitation generally applies at the taxpayer level. For partnerships and S Corporations, the limitation applies at the entity level.
- **Modification of Net Operating Loss Deduction:** For NOLs generated in tax years ending after December 31, 2017, the two-year carryback rule has been repealed. For losses generated in tax years beginning after December 31, 2017, the NOL deduction is generally limited to 80% of taxable income.

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- **Domestic Production Activities Deduction:** The Domestic Production Activities deduction has been repealed for tax years beginning after December 31, 2017.
- **Like-Kind Exchange Treatment:** Effective for tax years beginning after December 31, 2017, the like-kind exchange rules have changed to disallow the deferral of gain on exchanges of personal property.
- **Opportunity Zone Program:** This program was created under the tax reform to promote investment in economically distressed communities. There are over 8,700 certified Qualified Opportunity Zones in all 50 states, the District of Columbia, Puerto Rico and the Virgin Islands. This program allows for a temporary deferral of capital gains that are re-invested in a Qualified Opportunity Zone.
- **Cash Method Accounting:** The annual gross receipts threshold for mandatory use of the accrual method of accounting was increased from $5 million to $25 million. This change dramatically increases the number of taxpayers that are eligible to use the cash method of accounting.
- **Accounting for Inventories:** For tax years beginning after December 31, 2017, taxpayers that meet the $25 million gross receipts test are not required to capitalize inventory costs, but they may use an accounting method for inventories that either (1) treats inventories as non-incidental materials and supplies or (2) conforms to the taxpayer's financial accounting treatment for inventories.
- **Work Opportunity Tax Credit:** The WOTC has been extended through 2019 for employers who hire employees from specific groups who have faced barriers to employment.
- **Paid Family Leave Credit:** For the 2018 and 2019 tax years, businesses can claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which the employee is on Family and Medical Leave if the employee received payment of 50% of wages he or she would normally receive.
- **Partnership Audit Rules:** For tax years beginning after December 31, 2017, unfavorable changes have been made to the way in which partnership returns will be audited by the IRS. The new rules may cause the partnership itself to become liable for underpayments of federal tax by its members, both past and present, relating to their respective shares of partnership income. Elections are available that may allow the partnership to reduce or eliminate its potential liability if made in a timely manner. The partnership will also be responsible for designating a partnership representative (PR). The PR will have significant decision-making power and authority that could have a substantial impact on all partners and the partnership in the event of an examination.

CONCLUSION

When discussing your 2018 tax situation and tax-savings strategies with your advisor, the focus should be centered on the TCJA's provisions and how they impact your specific tax situation. You can view Warren Averett's latest tax reform articles and industry content on our Insights section. If you have any questions about these year-end planning topics and how they may affect you and your business, please contact your Warren Averett advisor.