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PLEASE NOTE NEW ADDRESS – OUR NEW OFFICE IS NEXT TO OUR OLD ORLAND PARK OFFICE BUT IS ACCESSED THROUGH A SEPARATE DOOR (EAST OF THE OLD OFFICE)

Dear Reliance Accounting Client:

Individual Taxpayer Changes

So it looks as if the Republican tax plan should become law before the end of the year. NOTE: THESE CHANGES HAVE NOT BEEN SIGNED INTO LAW SO THERE IS A CHANCE THAT PROVISIONS COULD BE ALTERED. There are a number of changes in the proposed legislation. Listed below are the major provisions impacting individual taxpayers as well as potential action steps to take before year end to reduce your tax liability.

While the proposed legislation reduces the tax rates for the vast majority of taxpayers and raises the standard deduction amount, there are some negatives in the new law such as capping the income tax, sales tax and real estate tax deduction to $10,000 beginning in 2018 and the elimination of the personal exemption deduction.

Proposed Law: Limit the income tax, sales tax and real estate tax deduction to $10,000 combined beginning in 2018

Proposed Law: Increase the standard deduction to $24,000 for couples, $18,000 for Head of Household and $12,000 for individual taxpayers in 2018

Action Plan 1: Taxpayers should consider **prepaying their real estate taxes to get the deduction in 2017** as in 2018 the income tax, sales tax and real estate tax deduction tax is proposed to be reduced to $10,000 combined. With that limitation in place many taxpayers will not be over the threshold to itemize ($24,000 for couples, $18,000 for Head of Household and $12,000 for individuals) in 2018 so they will not receive a benefit for any income tax, sales tax and real estate tax paid in 2018.

Note: Prepaying your real estate taxes is fairly easy if you are paying your real estate taxes directly. Contact your county collector for information on prepaying your taxes. Prepaying your real estate taxes for those that escrow taxes with their mortgage may be more complicated. You would have to contact your mortgage lender to determine if they have a procedure for prepaying real estate taxes. Complicating things further… If you are in Alternative Minimum Tax in 2017 you may not receive a full benefit for prepaying your real estate taxes.

Action Plan 2: Increase charitable contributions (ie **prepay your 2018 charitable contributions in 2017**) for the same reason as the discussion above as many taxpayers will use the standard deduction in 2018.

Action Plan 3: **Use your minimum required distribution (for taxpayers age 70 ½ or older) and other IRA distributions to contribute to charities**. Under this strategy you will reduce your incomes taxes even if you don't itemize in 2018.

Action Plan 4: **Make sure you pay in all of your state income taxes in 2017** (ie make sure you don't owe state income taxes when we file your return this year)

Current status of tax legislation:

Deductions and credits	**Current law**	**House bill**	**Senate bill**
Mortgage interest (1)	$1 million primary, second homes and some home equity debt	Limited to $500,000 of mortgage debt on a primary residence. Eliminates deduction for interest on new home equity loans	$1 million limited to primary residence. Eliminates the deduction for equity debt – refinancing debt not related to improving your home
State and local tax deduction (2)	Deductible	Capped at $10,000 for property taxes, no deduction for sales or income tax	Capped at $10,000 for property taxes, no deduction for sales or income tax
Medical expense deduction (3)	Expenses greater than 10% of AGI are deductible	Eliminated	Expenses greater than 7.5% of AGI could be deducted for the next 2 years only.
Adoption expense tax credit	Expenses up to $13,570 qualify	No change	No change

(1) It appears the House and Senate have agreed to a limit of $750,000 mortgage debt
(2) It appears that the combination sales or income tax and property taxes will limited to $10,000
(3) At this point the medical expense deduction (7.5% of AGI) appears to be retained for 2017 & 2018

Current status of tax legislation (continued):

Personal Exemptions eliminated.

Child Tax Credit Increased from $1,000 to $2,000 ($1,400 is refundable). Increases AGI phase out range.

Increases alternative minimum tax (AMT) exemption amount.

Individual health care mandate tax eliminated in 2019

Changes to capital gains and tax-loss harvesting as follows:

> The proposed rule would require the use of a "first in, first out" (sometimes referred to as FIFO) approach to tax lot accounting. That means when shares are sold, the gains or losses would be computed based on the cost basis of the earliest shares you purchased. That may limit flexibility when strategically choosing tax lots to manage capital gains and for many tax-loss harvesting strategies. The gifting of securities to charity would, in general, be less severely affected, because it's usually in an investor's best interest to give away the lots with the lowest cost basis. Given rising markets, these are more often than not the first lots to be purchased.

There are many other provisions in the proposed legislation that change current tax law:

- Rates lowered and rate structure changed
- Estate tax exemption increased
- Alimony not deductible by the Payer and not includable in income for divorce decrees entered into 12/31/18 or later
- 529 Plans used to pay for K-12 expenses

Business Tax Changes

The foundation of both the House and Senate bills -- regardless of how the plans were sold to the public -- has always been the **drop in the corporate tax rate from 35% to something as close as possible to 20% (the agreement reduced the rate to 21%).** But if you reduce the corporate rate without a corresponding incentive being given to partners, shareholders and sole proprietors, those business types would suddenly become disadvantaged relative to their corporate brethren. As a result, both the House and Senate sought to give a tax break to these business owners, though they went about it in very different ways.

In the conference committee, the Senate approach won out. As a result, sole proprietors, S corporation shareholders, and partners in a partnership will be entitled to a deduction equal to **20% of their allocable share of business income.**

As was the case in the Senate bill, however, the deduction comes with numerous caveats:

- Generally, the deduction cannot exceed 50% of your share of the W-2 wages paid by the business (if above the specified earnings thresholds)
- Alternatively, the limitation can be computed as 25% of your share of the W-2 wages paid by the business, PLUS 2.5% of the unadjusted basis (the original purchase price) of property used in the production of income.
- **The W-2 limitations do not apply if you earn less than $157,500 (if single; $315,000 if married filing jointly).**
- Certain "personal service businesses" -- i.e., accountants, doctors, lawyers, etc... -- are not eligible for the deduction, unless their taxable income is less than $157,500 (if single; $315,000) if married.In its simplest form, it works like this:

In its simplest form: Individual A is a 30% owner of a manufacturing S corporation. His share of income in 2018 is $700,000, and his share of the W-2 wages of the S corporation are $200,000. A is entitled to a deduction equal to the LESSER OF:

1. *20% of $700,000, or $140,000, or*
2. *50% of his share of the W-2 wages of the S corporation, or $100,000.*

Thus, A can take a deduction of $100,000 on his return.

It's important to note, the committee report makes clear that the deduction will be taken on the top of Page 2 of Form 1040, rather than on Page 1 where it would reduce adjusted gross income and potentially cause the taxpayer to lose or gain other benefits.

The final bill adds a new wrinkle for **real estate**: the ability to take the 20% deduction up to 25% of W-2 wages (although most entities holding real estate don't pay wages) **PLUS 2.5% of the original cost of business property**.

Other Business Tax Changes

	Current:	Proposed
Section 179 limitation	$510,000	$1,000,000
100% expensing	n/a	through 2022, then phase down over five years
Interest expense deduction	unlimited	limited to 30% of adjusted taxable income if avg receipts > $25M
Net operating losses	carry back 2 years, forward 20	no carry backs, carry forwards limited to 80% of taxable income
Section 199 deduction	allowed for domestic production	eliminated