Tax Notes

Selected Individual Tax Provisions in the New Tax Law: Planning Ideas

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The Tax Cuts and Jobs Act Bill (the Act) was passed by Congress on December 20, 2017. The Act contains significant tax changes which clearly require separate analysis to see how specific provisions impact each individual. There is no cookie cutter approach to this analysis.

Most of the individual provisions are effective from January 1, 2018 through December 31, 2025, then sunset back to the law as it was in 2017 unless otherwise changed or extended. The new legislation presents many opportunities and, of course, potential pitfalls.

Due to the complexity of many of the new provisions, it may take several months — even for sophisticated tax professionals — to fully understand each provision of the new law and how clients may be impacted. The following represents a sample of some of our initial planning considerations. More articles will follow as we continue to analyze the provisions of the new law.

Individual Tax Rates and Brackets

Maximum tax rates have been reduced from 39.6% to 37% and the income ranges within each bracket have been modified.

> ***PKF O'Connor Davies Observation:*** With the top tax rate being reduced and many itemized deductions being eliminated, it is not always clear if a taxpayer will benefit or not under the new law. Will the benefit for the reduction in tax rates be outweighed by the lost deductions, especially in the high income tax states? Many timing decisions do not have to be made presently, but tax planning should be a year-round process, so start now. Plan ahead for 2018 as these changes will certainly impact your 2018 tax obligations.

Retirement Plans

The new law did not make any significant changes to the retirement planning area and generally retains the old rules for 401(k) and other retirement plans. With many lost deductions, the benefits of retirement accounts appear to be more significant than in prior years.

> ***PKF O'Connor Davies Observation:*** In addition to maximizing your 401(k), consider establishing a more robust retirement plan such as a SEP IRA, cash balance, profit sharing or defined benefit plan. Potential benefits include tax deferred or tax free growth, and this growth is not subject to the 3.8% net investment income tax. Some of these plans must be established before October 1, 2018, so plan ahead. Large deductions for these plans reduce your adjusted gross income, which could impact one's ability to qualify for the 20% deduction for Qualified Business Income as discussed below.

Pass-through Deduction and Entity Selection

This new deduction under IRC Section 199A may allow owners of sole proprietorships, S corporations and partnerships, as well as individually-owned rental properties, to take a deduction up to 20% against their income. This deduction, if received, would reduce the top tax rate on this type of income to 29.6% (37% less a 20% or 7.4% deduction equaling 29.6%).

> ***PKF O'Connor Davies Observation:*** The new 20% deduction for Qualified Business Income is extremely complicated and contains many hurdles in order to secure the deduction. This deduction is claimed on your individual tax return and is well beyond the scope of this article. With that said, many clients are considering a change in their business structure to try to capture this deduction. Consider restructuring your form of doing business depending on the business that you are in. Our firm will be preparing additional Thought Leadership articles on this topic.

Itemized Deductions/Doubling of Standard Deduction to $24,000 (Married) and $12,000 (Single)

State and Local Taxes*:* The state and local income, property and sales tax deductions have been reduced to a maximum deduction of $10,000.

Miscellaneous Itemized Deductions: The deductions for employee business expenses, investment management fees and many other miscellaneous deductions, including those from pass-through activities, have been eliminated or scaled back.

> ***PKF O'Connor Davies Observations:***
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> Bunching of Deductions: Since many itemized deductions have been eliminated or reduced, where there is a strong likelihood of itemizing your deductions one must properly plan and consider the bunching of deductions into a specific tax year or the deduction could be "wasted." Perhaps itemize every other year. Specifically, this is applicable to charitable contributions and medical expenses as two of the few remaining deductions.
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> Medical Expenses: The deduction threshold has been reduced to 7.5% of Adjusted Gross Income (AGI) through 2018. After 2018, and through 2025, the threshold returns to 10%. Consider the timing of the payment of medical expenses.
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> Mortgage Interest Expense: The amount of mortgage interest that you are allowed to deduct on your personal residence and qualified second residence has been limited to interest on $750,000 of indebtedness on new mortgages acquired after December 15, 2017. (The prior $1,000,000 limit is retained if acquired prior to this date.) The deductibility of mortgage interest on a home equity line of credit (HELOC) has been eliminated. Consider refinancing your HELOC to preserve the deductibility of your mortgage interest.
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> Rental Property: Consider the purchase of a rental property. Property taxes, mortgage interest and related business expenses are generally fully deductible as long as they relate to the rental property. (***Note:*** The ability to currently deduct losses may be limited by the Passive Activity Loss rules.)

Gift, Estate and Generation-Skipping Transfer Tax

The Unified Credit has been doubled to $11.2 million per individual.

> ***PKF O'Connor Davies Observation:*** Since the exemption is doubled to $11.2 million, individuals may wish to consider significant gifts to maximize the benefit of this increased exemption. Careful consideration should be taken **prior** to making any gifts to ensure it is done properly.

Note: Gift tax annual exclusion increased to $15,000 in 2018. This provision was already scheduled and has not changed with the new law.

Plan Now

Planning under the new tax law requires many complicated considerations and calculations to determine how it impacts your own individual tax situation. Our advice: begin planning as soon as practical to ensure all facts and opportunities are considered.

Contact Us

Your PKF O'Connor Davies tax team is closely following developments with the new law and, as the IRS catches up to the new legislation and begins writing interpretive rules and regulations, we will keep you updated.

We are available to assist our clients in understanding how the new law affects their particular situation. Please contact either Douglas Ruttenberg, CPA, Partner at druttenberg@pkfod.com or Alan Kufeld, CPA, Partner at akufeld@pkfod.com, or your PKF O'Connor Davies tax advisor.

About PKF O'Connor Davies

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