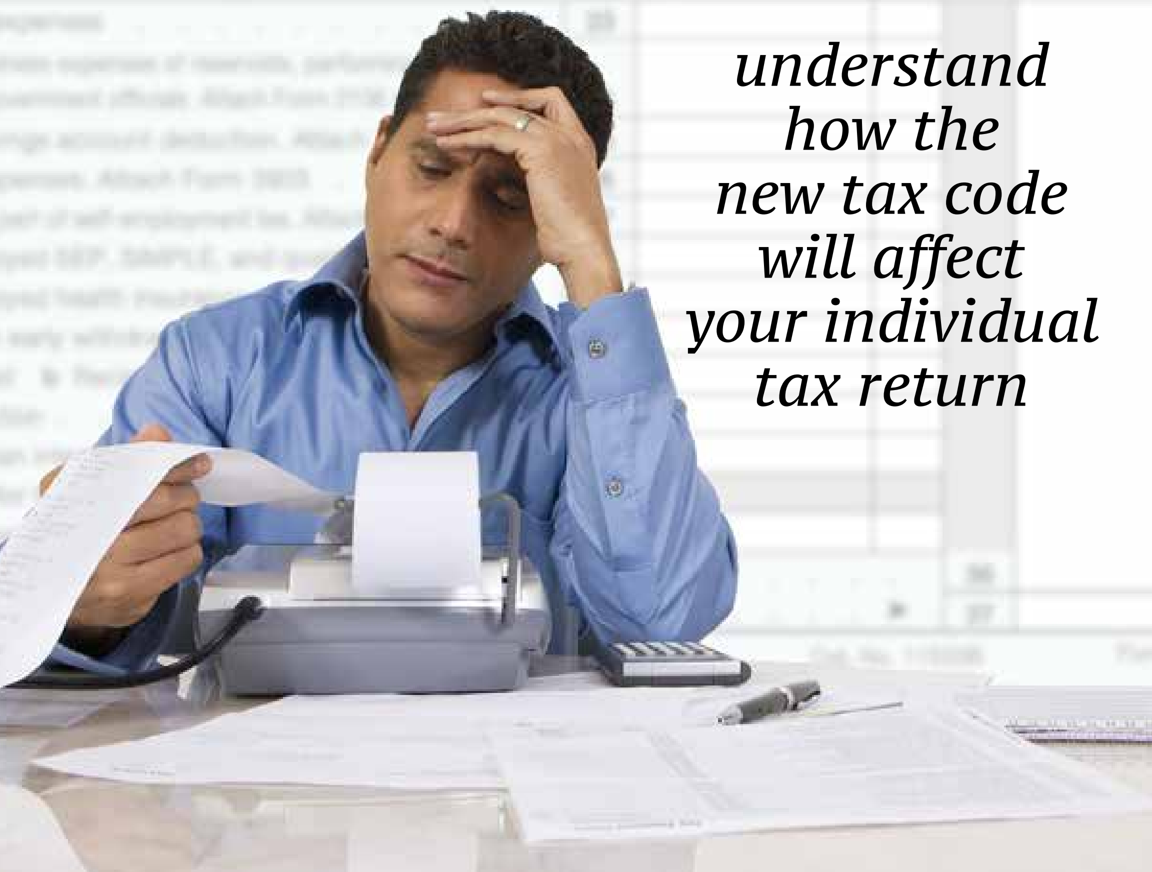
CRACK THE CODE

understand how the new tax code will affect your individual tax return



New Lower Tax Rates

The new tax laws passed in December of 2017 created lower tax rates for almost everyone. Now, the first thing you need to know is that the tax rates are only half of the equation. This is because your tax rates are multiplied by your taxable income. And your taxable income will change for self-employed people under the new laws as well.

So, although most people will benefit, everyone won't automatically pay less in taxes. Here are the new tax rates for 2018:

Tax Brackets for Single Filers

2017		2018	
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 or more	37%	$500,001 or more
Standard deduction	$6,350	Standard deduction	$12,000
Personal exemption	$4,050	Personal exemption	Eliminated

Tax Brackets for Married Taxpayers Filing Jointly

2017		2018	
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 or more	37%	$600,001 or more
Standard deduction	$12,700	Standard deduction	$24,000
Personal exemption	$8,100	Personal exemption	Eliminated

Now that we have shown you the new tax rates, let's look at the changes that will impact your taxable income.

Doubled the Standard Deduction, But Eliminated Exemptions

Have you seen a magician do a shell game? You know, the trick where they put an object under some cups and move it around? You think you know where the magician put the object. But using slight of hand, it shows up in an unlikely place? Well, understanding this next section can be hard to follow. So we will try to do our best and illustrate with examples.

Let's start by talking about the Standard Deduction.

Under the Tax Cuts and Jobs Act, the standard deduction is almost doubled to be $12,000 for single people and $24,000 if you are married and filing a joint return. What does this mean? Let's say you make $75,000. In this case, if you were married and filing a joint return, you would subtract $24,000 from your income. Then you would multiply your income by your tax brackets. So, you would only pay taxes on $51,000 of income.

	Old Law	*New Law*
Income	$75,000	$75,000
Standard deduction (married)	($12,700)	($24,000)
Taxable income	$62,300	$51,000
Taxes owed (using tax rates)	**$8,412**	**$5,739**

Are you with me so far? Good. Now the doubling of the standard deduction sounds wonderful. However, the new law eliminated all exemptions for the family. Except, the ones for those who are blind and over age 65.

Under the old law, you could deduct up to $4,100 per person that was a dependent as an exemption. This includes your kids still living at home and your spouse.

So to continue with our example above. Let's say you have 2 kids that were dependents. Under the old law you would get to deduct $4,100 for you. $4,100 for your spouse. And $4,100 for each of your kids! That totals $16,400 that you get to deduct. So now our comparison looks like this:

	Old Law	*New Law*
Income	$75,000	$75,000
Standard deduction (married)	($12,700)	($24,000)
Exemptions ($4,100/person)	($16,400)	0
Taxable income	$45,900	$51,000
Taxes owed (using tax rates)	**$5,952**	**$5,739**

We are not done yet, but our analysis so far shows that for this particular example, their taxable income is higher.

Increase in Child Tax Credit

To help offset the loss of the personal exemptions, Congress increased the child care credit from the current $1,000 to $2,000 per qualifying child under age 17. In addition, a $500 credit is provided for certain non-child dependents. And to make it even better, up to $1,400 of this credit is refundable for each qualifying child. This means that if you didn't owe enough taxes, you can get this excess back as a refund. This provision is designed to especially help those people with lower income.

A credit is better than a deduction. Because a credit actually means you get savings dollar for dollar. In our running example, you would take your taxable income, and multiply it by their tax brackets. You can see this has been done in the table below. Then we apply the tax credits. And you can see, in the end, it is quite a bit better in this example.

	Old Law	*New Law*
Income	$75,000	$75,000
Standard deduction (married)	($12,700)	($24,000)
Exemptions ($4,100/person)	($16,400)	0
Taxable income	$45,900	$51,000
Taxes owed (using tax rates)	**$5,952**	**$5,739**
Child credits (2 kids)	($2,000)	($4,000)
New amount of Taxes owed	**$3,952**	**$1,739**

However, a caution. What Congress gives they tend to take back. This credit phases out for single taxpayers earning over $200,000 and for married filing joint taxpayers who earn over $400,000. There is a hot tip in our book, ***"7 Simple Ways To Navigate The New Tax Laws - for the Self-Employed"***. If you haven't ordered that book yet, you should do so at **book.taxbot.com**.

Cap of the Deduction for State and Local Taxes (SALT)

Before 2018, you could deduct all the taxes you paid to your state and local municipalities. This deduction lowered your federal tax. However, under the new law, your deduction for SALT is capped at $10,000!

This includes property tax, sales tax, and state income tax. Now in reality, this deduction doesn't impact most people. Because you only get to deduct SALT if you don't take the standard deduction and you decide to itemize your deductions. But with the standard deduction doubling, more people will be taking the standard deduction than before.

Miscellaneous Itemized Deductions Suspended

Prior to the Tax Cuts and Job law, you could deduct certain non-business expenses as a miscellaneous itemized deduction. These deductions were subject to a threshold of 2% of your Adjusted Gross Income. Under this rule, you were able to deduct things like tax preparation fees, safe deposit boxes, investment journals, employee business expenses etc.

The new law suspends all miscellaneous itemized deductions until January 1, 2026.

There will be unintended consequences of this section. In fact, accountants will be finding unintended problems for years. For example, all gambling losses and expenses are deductible up to the amount of gambling winnings. Gambling losses and expenses must be reported as miscellaneous itemized deductions, which could possibly result in the elimination of these deductions and losses.

Kiddie Tax Modified

In most tax law, people are taxed based on how much money they personally make. Thus, if I earn $5,000, I am taxed personally for that money. However, there is something in the tax code called the kiddie tax. In our opinion, this is a stupid departure from logical thinking. And here is why.

If a child has unearned income, such as investments, then the first $2,100 is taxed at their individual rates. But, anything above that is taxed at the highest rates in the IRS code - the trust rates. Money that they earn is still taxed at their normal rates. This just affects their unearned (investment) income.

Here is who it affects:

- Children under age 24, who are full time students, and unmarried.
- Children under 18 and not married *(seems odd that they qualified them as not married... maybe this happens more than I think).*

Casualty Losses Eliminated

This is a strange change indeed. If you have a loss from a catastrophe, and your insurance doesn't pay out, you cannot deduct it unless they happen in a federally declared disaster area. Thus, you only get a deduction if the federal government declares it a disaster. So if your home burns down, and the insurance doesn't pay, and it's not a federal disaster, then you lose. Disasters include losses from fire, storm, shipwreck, tornado, hurricane, earthquake, and theft.

This is just one more good reason to make sure you have good insurance for all your valuables.

Gambling Losses & Expense Limits

Do you like to gamble? The old rule allowed you to deduct gambling losses as itemized deductions. But you were only allowed to deduct losses equal to your gambling winnings. However, if you had other gambling expenses such as lodging, transportation and admission fees, you could deduct them as itemized deductions regardless of winnings.

The new law allows all the expenses to be deducted. They are still limited to the extent of gambling winnings. However, all these expenses must be claimed as a miscellaneous itemized deduction. And here is the rub. The new law eliminated the miscellaneous deductions. So, we all just need to gamble and see what the IRS says as it clarifies legislation. It is very possible that all gambling losses and expenses may be disallowed. We won't know until IRS issues some guidance on this area.

Modification of Home Mortgage and Home Equity Interest Deduction

Prior to the Tax Cuts law, you could deduct home mortgage interest up to $1,000,000 of debt if used for either the acquisition, or improvement of your principal or secondary residence. In addition, you could claim an interest deduction on up to another $100,000 of home equity debt.

New law: Until December 31, 2025, you can't deduct interest on a home equity line of credit. And this law is retroactive. So, if you have a home equity line of credit, you won't get a deduction for the interest starting in 2018.

The new law also placed a cap on interest allowed on your mortgage. You can deduct interest on up to $750,000 of debt now. However, a person who has entered into a binding written contract before December 15, 2017 to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, will be okay. They will be allowed to continue their purchase as if they were under the old law. They did this so that people who had decided to buy a property under the old law, wouldn't be hurt by this new law being suddenly in place.

Medical Expense Deduction Threshold Temporary Reduced[1]

Under the old law, you could claim medical expenses if they exceeded 10% of adjust gross income. This was lowered to 7.5% under the new law, but only until January 1, 2019. The reduced 7.5% threshold was also made retroactive for 2017.

This rule helps people who have unusually high medical expenses. For example, lets imagine someone who has medical bills of $15,000. But they only make $30,000 of income. Under this rule the patient could deduct anything that is greater than 7.5% of their income. 7.5% of $30,000 = $2,250. So, anything above that number could be a deduction. If you have a high income, it is unlikely you will be able to deduct your medical expenses.

[1]IRC Section 213(f), as amended by Act Section 11027(a)

Charitable Contributions Deduction Limitation Increased

Prior to the new law, you were only able to get a deduction for cash contributions if the amount contributed was less than a percentage of your income. The rates were 50% for public charities and 20-30% for private charities. So, if you made $100,000 you could give away $50,000 (50%) to a public charity. In addition, any contributions of $250 or more needed an acknowledgment from the charity for proof of the donation.

Under the new law, cash contributions made before January 1, 2026, can now be up to 60% of your adjusted gross income. This also applies to certain private foundations too. Moreover, contributions made on or after January 1, 2017, will no longer need to receive an acknowledgment from the charity for contributions of $250 or more.

No Deduction for Amounts Paid for College Sports Tickets

Prior to the new law, some colleges required a "contribution" to the university to be able to buy sports tickets. The person paying could claim, under some circumstances, 80% of the payment as a charitable contribution.

The new law eliminates this deduction as a charitable contribution, if made after December 31, 2017, if the person receives any right to purchase tickets or seating at an athletic event.

Alimony Deduction Eliminated and No Income for the Recipient

Before the Tax Cuts law, you could deduct payments that qualified as alimony to your spouse. The spouse would have to pick up these payments as income.

Under the new law, for any divorce or separation agreement executed after December 31, 2018, or executed before that date but modified after it, alimony will no longer be deductible by the paying spouse. But, it will also not be claimed as income by the spouse who receives the money.

Qualified Bicycle Commuting Exclusion Suspended[2]

Under pre-Tax Cuts law, an employee could exclude up to $20 per month in qualified bicycle commuting reimbursements.

Starting after December 31,2017, and before January 1, 2026, the exclusion from gross income and wages for qualified bicycle reimbursements is suspended.

[2]IRC Section 132(f)(8), as added by Act Section 11047

Exclusion for Moving Expenses Reimbursed by Employer Suspended[3]

Under the old law, an employee could exclude qualified moving expenses reimbursements from his or her gross income and from his or her wages.

Beginning on January 1, 2018 and ending before January 1, 2026, the exclusion for qualified moving expenses reimbursements is suspended with the exception for members of the Armed Forces on active duty and for their spouses and dependents who move pursuant to a military order and incident to a permanent change of station.

[3]IRC Section 132(g), as amended by Section 11048

Moving Expense Deduction Suspended[4]

Under pre-Tax Cuts law, an employee could claim a deduction for moving expenses incurred in connection with starting a new job if they meet certain distance requirements.

The new Tax Cuts law suspends the moving expense deduction except for people who are on active duty with the armed forces. The suspension begins after December 31, 2017 and ends before January 1, 2026.

[4] *IRC Section 217(K), as amended by Act Section 11049(a)*

Repeal of ACA Individual Mandate[5]

Under the pre-act law, the Affordable Care Act (ACA) required individuals who were not covered by a health plan to pay a penalty. The penalty was applied if their plan didn't provide at least minimum essential coverage.

[5] *IRC Section 5000©, as amended by Act Section 11081. The repeal is permanent.*

Alternative Minimum Tax (AMT) Retained with Higher Exemptions

The AMT is a tax system that is separate from the regular tax that is intended to prevent higher income people from avoiding all tax liability by using various deductions, exclusions and credits. The pre-Tax Cuts law exemptions were:

i. $86,200 for married filing joint taxpayers
ii. $55,400 for single individuals
iii. $43,100 for married filing separately

The new Tax Cuts law, beginning January 1, 2018 and ending before January 1, 2026 increases the exemption amounts as follows:

i. For joint returns and surviving spouses, $109,400
ii. For single taxpayers, $70,300
iii. For married filing separately, $54,700.

Also, the above exclusions are reduced by 25% over the following phased-in amounts:

i. For joint returns and surviving spouses, $1 million
ii. For all other taxpayers, other than for estates and trusts, $500,000

ABLE Account Changes

ABLE accounts are little known accounts used to provide for individuals with severe disabilities and for their families to fund a tax-preferred savings account to pay for support, education, and maintenance. Prior to the Tax Cuts law, the annual contribution limitation was the amount of the annual gift tax exemption, which in 2018 will be $15,000.

Effective for tax years beginning after the enactment date and before January 1, 2026, the limit on the annual contribution has been increased. Once the annual exclusion has been reached, an ABLE accounts designated beneficiary can contribute an additional amount, up to the lesser of (a) the Federal Poverty line for a one-person household, or (b) the individual's compensation for the tax year.

Expanded Use of Section 529 Funds for Private School Tuition[6]

Under pre-Tax Cuts law, funds in a section 529 account could only be used for qualified higher education expenses. These included college and grad school costs for tuition, fees, books, supplies, and required equipment as well as reasonable room and board if the student was enrolled at least half-time. Eligible schools included colleges and universities, vocational schools or other post-secondary schools eligible to participate in a student aid program of the Department of Education.

For distributions made after December 31, 2017, the new law includes up to $10,000 of tuition at an elementary or secondary public, private or religious school.

[6] *IRC Section 529©(7), as amended by Act Section 11032(a)*

Student Loan Discharged on Death or Disability[7]

Gross income generally includes any discharge from indebtedness of a taxpayer. For example, if you owe me $100,000 and I forgive the debt, then you have to claim $100,000 as income. An exception to this rule is that gross income does not include any amount from the forgiveness of certain student loans if the forgiveness is contingent on the student's working for a certain period in certain professions.

Starting after December 31, 2017 and before January 1, 2026, certain student loans that are discharged because death, or total and permanent disability, of the student are also excluded from gross income.

[7] *IRC Section 108(f) as amended by Act Section 11031*

Estate and Gift Changes[8]

Under pre-Tax Cuts law, the first $5 million adjusted for inflation was exempt from estate and gift tax. For decedents dying and gifts made after December 31, 2017 and before January 1, 2026, the new law doubles the estate and gift tax exemption from $5 million to $10 million, which is indexed for inflation occurring after 2011. Thus, it is expected to be around $11.2 million by 2018. What this means is that when a loved one passes on, they can gift up to $10,000,000 tax free. Plus, it is important to note that each spouse gets their own exemption. Thus, the exemption for a couple should be about $22.4 million in 2018.

[8] *IRC Section 2010©(3), as amended by Act Section 11061(a)*

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