

LANG ALLAN & COMPANY CPA

2018 TAX GUIDE

For 2018, there are significant tax changes in effect for you personally and/or for your business.



WE EXPECT SOMETHING IN THE HIGHLIGHTS WILL
IMPACT EVERY CLIENT'S PERSONAL AND/OR
BUSINESS TAXES FOR 2018.

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Tax Cuts and Jobs Act Analysis

Overview

By now you have heard about and maybe even read somewhere on the internet about the 2017 Tax Cuts and Jobs Act (“Act”) signed on December 20, 2017, which primarily addressed 2018 (and beyond) taxes both personally and for businesses. The Act is the most robust change and update to our tax landscape since the Internal Revenue Code of 1986.

Below is a summary (and not all inclusive) of the Act to alert you as we approach year end. For 2018 there are significant tax changes in effect for you personally and/or for your business. We are encouraging clients to review the information below and schedule an early tax planning session. Wait too long and you will not be able to make appropriate adjustments prior to year-end!

We expect something in the highlights below will impact every client’s personal and/or business taxes for 2018.

Please contact our office to schedule a year-end tax planning meeting/conference call for us to review information as pertains to your circumstances and conduct an analysis for you prior to year-end. Please call our office at 303-792-9445 and Neena can assist you in scheduling this meeting/conference call.

If you prefer to read the full text of the act, you can find it [here](#) (hope you have plenty of days available!).

For the years 2018 - 2026 Individual Highlights:

- Tax rates – have dropped each bracket by approximately 2%.
- Standard deductions increased to \$24,000 for married filing jointly, \$18,000 for head of household and \$12,000 single taxpayers.
- Personal exemptions are now zero.
- Kiddie tax is now taxed at single rates and net unearned income is taxed at trust and estate rates.
- Capital gains rates of 0%, 15% and 20% remain in effect.
- Carried interest for certain partnership interests must be held now for 3 years for long-term treatment.
- Excess business loss is now limited and certain NOL's will be carried forward.
- Personal casualty & theft losses suspended.
- Gambling loss limitation modified to provide that all deductions for expenses incurred in carrying out wagering transactions, and not just gambling losses, are limited to the extent of gambling winnings.
- Child tax credit increased.
- State and local tax (SALT) deduction limited to \$10,000 (i.e. state income taxes and real estate tax deduction).
- Mortgage interest deduction limited. Certain limitations are in effect for mortgages closed after December 15, 2017 and houses that were purchased prior to April 1, 2018 and certain home-equity lines.
- Charitable contribution deduction limitation increased; however, no deduction for which payor received the right to purchase tickets or seating at an athletic event.
- Alimony deduction by payor/inclusion by payee suspended.
- Miscellaneous itemized deductions suspended.
- Moving expenses deduction suspended.
- AMT didn't disappear, however higher AMT exemption amounts.
- Estate and gift tax exemption increased.
- Increased due diligence on prepares who file returns for head of household status.
- ROTH IRA recharacterizations repealed.

For years 2018 + Business Highlights:

- Corporate tax rate now a flat 21% (blended rate in year 1 for fiscal year ends).
- Dividends-received deduction reduced.
- Corporate AMT repealed.
- Increased Section 179 expense to \$1 million and phase out now \$2.5 million. Bonus depreciation to be phased out through 2025.
- Qualified real property also defined and subject to Section 179.
- Luxury automobile limitations increased.
- Changes to farming business depreciation lives and method.
- Limits on deduction of business interest.

- NOL carryback is repealed (certain exclusions for farmers intact).
- Domestic production activities repealed.
- Like-kind exchanges limited to real property that is not held primarily for sale.
- Deduction of entertainment expenses are disallowed.
- Tax credits for employer paid family and medical leave act.
- Below \$25 million gross receipts test, the following have different applicable accounting rules (i) cash basis method of accounting, (ii) accounting for inventories, (iii) accounting for long-term contracts and (iv) limits on deduction of business interest.

For years 2018 + Pass-through Highlights:

- Qualified business income pass-through deduction.
- Partnership technical termination repealed.

Certain of these items will revert back to Pre-Act levels/computations beginning in 2026.

Greater Detail of the Individual Highlights Above:

Tax rates

The new law imposes a new tax rate structure with seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top rate was reduced from 39.6% to 37% and applies to taxable income above \$500,000 for single taxpayers, and \$600,000 for married couples filing jointly. The rates applicable to net capital gains and qualified dividends were not changed.

Kiddie tax

The “kiddie tax” rules were simplified. The net unearned income of a child subject to the rules will be taxed at the capital gain and ordinary income rates that apply to trusts and estates. Thus, the child's tax is unaffected by the parent's tax situation or the unearned income of any siblings.

Capital gains

The Act generally retains present-law 0%, 15%, and 20% tax rates on net capital gains and qualified dividends. It also retains the pre-Act law breakpoints at which the 15% and 20% tax rates begin to apply, but indexes them for inflation using C-CPI-U in tax years after December 31, 2017. For 2018, the 15% breakpoint is \$77,200 for joint returns and surviving spouses, \$51,700 for heads of household, \$38,600 for single taxpayers, \$38,600 for married taxpayers filing separately, and \$2,600 for trusts and estates. The 20% breakpoint is \$479,000 for joint returns and surviving spouses, \$452,400 for heads of household, \$425,800 for single taxpayers, \$239,500 for married taxpayers filing separately, and \$12,700 for estates and trusts.

Excess business loss

The Act provides the excess farm loss limitation doesn't apply. Instead, a noncorporate taxpayer's “excess business loss” for a tax year is disallowed, and the disallowed loss is carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in later tax years. This limitation applies after the application of the passive loss rules.

Carried interest

For tax years beginning after December 31, 2017, the Act effectively imposes a 3-year holding period requirement in order for certain partnership interests received in connection with the performance of services (“carried interests”) to be taxed as long-term capital gain. If the 3-year holding period is not met with respect to an applicable partnership interest held by the taxpayer, the taxpayer's gain will be treated as short-term gain taxed at ordinary income rates.

Gambling losses

The limitation on wagering losses is modified to provide that all deductions for expenses incurred in carrying out wagering transactions, and not just gambling losses, are limited to the extent of gambling winnings. Thus, under the Act, those in the trade or business of gambling may no longer deduct non-wagering expenses, such as travel expenses or fees, to the extent those expenses exceed gambling gains

Child tax credit

The child tax credit is increased to \$2,000. The income levels at which the credit phases out are increased to \$400,000 for married taxpayers filing jointly (\$200,000 for all other taxpayers) (not indexed for inflation). The amount of the credit refundable is increased to \$1,400 per qualifying child, and this amount is indexed for inflation, up to the base \$2,000 base credit amount. The earned income threshold for the refundable portion of the credit is decreased from \$3,000 to \$2,500. No credit will be allowed to a taxpayer with respect to any qualifying child unless the taxpayer provides the child's SSN. In addition, a \$500 nonrefundable credit is provided for certain non-child dependents.

State and local tax (SALT) deduction

State, local, and foreign property taxes, and state and local sales taxes, are deductible only when paid or accrued in carrying on a trade or business or an activity described in Code Sec. 212 (generally, for the production of income). State and local income, war profits, and excess profits are not allowable as a deduction.

However, a taxpayer may claim an itemized deduction of up to \$10,000 (\$5,000 for married taxpayers filing separately) for the aggregate of (i) state and local property taxes not paid or accrued in carrying on a trade or business or activity described in Code Sec. 212; and (ii) state and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the tax year. Foreign real property taxes may not be deducted.

Mortgage interest deduction

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. For tax years beginning after December 31, 2025, the pre-Act \$1 million/\$500,000 acquisition indebtedness limitations are restored and apply regardless of when the indebtedness was incurred, and the suspension for home equity indebtedness interest ends.

The new lower limit doesn't apply to acquisition indebtedness incurred before December 15, 2017.

A taxpayer who 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 the residence before April 1, 2018, is considered to incur acquisition indebtedness before December 15, 2017.

The pre-Act acquisition indebtedness limitations continue to apply to taxpayers who refinance existing qualified residence indebtedness that was incurred before December 15, 2017, provided the resulting indebtedness doesn't exceed the amount of the refinanced indebtedness.

Acquisition indebtedness is debt that's incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer. Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness, but only to the extent of the amount (and term) of the refinanced indebtedness.

Charitable contributions

For contributions made in tax years beginning after December 31, 2017 and before January 1, 2026, the 50% limitation under (Code Sec. 170(b)) 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 later year's ceiling.

In addition, contemporaneous documentation (i.e. receipt from the organization) must indicate the recipient did not receive any service or goods for the donation (or other benefits) for the donation to be deductible. No charitable deduction is allowed for any payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event.

Alimony

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 Act rules apply), alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse. Child care/support remains as a non-taxable event for both the payor and the recipient; the Act did not change the accounting for this.

Miscellaneous itemized deductions

The deduction for miscellaneous itemized deductions subject to the 2%-of-AGI floor is suspended. The most common deductions included in the past that are no longer allowed under the Act are the following: (i) unreimbursed employee business expenses (ii) unreimbursed vehicle expenses of rural mail carriers, (iii) investment expenses and expenses for the production or collection of income, (iv) tax determination expenses (v) expenses allowed under the “hobby loss” rules.

Alternative Minimum Tax/AMT

The Act increases the amount of an individual's alternative minimum taxable income (AMTI) that is exempt from AMT—the “AMT exemption” amounts—as follows:

- For joint returns and surviving spouses, \$109,400;
- For single taxpayers, \$70,300;
- For marrieds filing separately, \$54,700.

The above AMT exemption amounts are reduced (not below zero) to an amount equal to 25% of the amount by which the individual's AMTI exceeds a phase-out amount, increased as follows:

- For joint returns and surviving spouses, \$1 million.
- For all other taxpayers (other than estates and trusts), \$500,000.

Estate tax

For estates of decedents dying and gifts made, the Act doubles the base estate and gift tax exemption amount from \$5 million to \$10 million. The \$10 million amount is indexed for inflation occurring after 2011 and is expected to be approximately \$11.2 million in 2018 (\$22.4 million per married couple).

Greater Detail of the Business Highlights

Corporate tax rate

Under pre-Tax Cuts and Jobs Act law, corporations (i.e. C corporations for income tax purposes) were subject to graduated rates that resulted in a 35% corporate rate for income over \$10 million, with a phase out of the lower rates, while Personal service corporations (as defined) did not have the advantage of the lower rates and were taxed at a flat 35% rate. The Act reduces the corporate tax rate to a flat 21% rate.

Section 179

For property placed in service in tax years beginning after December 31, 2017, the maximum amount a taxpayer may expense under Code Sec. 179 is increased to \$1 million, and the phase-out threshold amount is increased to \$2.5 million. For tax years beginning after 2018, these amounts (as well as the \$25,000 sport utility vehicle limitation) are indexed for inflation.

Qualified real property

The definition of qualified real property eligible for Code Sec. 179 expensing is also expanded to include the following improvements to nonresidential real property after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems. Also any other building improvements to nonresidential real property that aren't elevators or escalators, building enlargements or attributable to internal structural framework are Code Sec. 179 property.

Bonus depreciation

A 100% first-year deduction for the adjusted basis is allowed for qualified property acquired and placed in service after Sept. 27, 2017, and before January 1, 2023. For assets placed in service between 2023 – 2027, the 100% bonus will be reduced 20% annually.

Luxury automobile

For passenger automobiles placed in service after December 31, 2017 for which the additional first-year depreciation deduction under Code Sec. 168(k) is not claimed, the maximum amount of allowable depreciation is increased to: \$10,000 for the year in which 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 in the recovery period. For passenger automobiles placed in service after 2018, these dollar limits are indexed for inflation. For passenger autos eligible for bonus first-year depreciation, the additional first-year depreciation allowance remains at \$8,000.

Farming cost recovery

For property placed in service after December 31, 2017, the cost recovery period is shortened from seven to five years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which commences with the taxpayer. In addition, taxpayers can use the 200% declining balance method--the 150% declining balance depreciation method is no longer required--for property used in a farming business (i.e., for 3-, 5-, 7-, and 10-year property) is repealed. The 150% declining balance method continues to apply to any 15-year or 20-year property used in the farming business to

which the straight-line method does not apply and to property for which the taxpayer elects the use of the 150% declining balance method.

Business interest deduction

Every business, regardless of its form, 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. However, for partnerships and S corporations, the limitation applies at the entity level.

Prior to 2022, taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Additional rules are in place for interest deduction, if you are in the trade or business of floor plan financing.

NOL deduction

The two-year carryback and the special carryback provisions are repealed, but a two-year carryback applies for certain losses incurred in the trade or business of farming. NOLs generally can be carried forward indefinitely. For losses arising in tax years beginning after December 31, 2017, the NOL deduction is generally limited to 80% of taxable income (determined without regard to the NOL deduction). Carryovers to other years are adjusted to take account of this limitation.

Domestic production activities deduction repealed

Code Sec. 199 domestic production activities deduction (DPAD) is repealed. DPAD, previously allowed for certain qualifying US based activities a deduction of the lesser of 9% of qualified production activities income or the taxpayer's taxable income.

Like kind exchanges

The rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property that is not held primarily for sale. Whereas the like-kind "tax gain deferral" was a prominent feature, the Act allows for increased bonus depreciation and section 179 of personal property.

Entertainment expenses disallowed

No deduction is allowed for: (1) an activity generally considered to be entertainment, amusement, or recreation, (2) membership dues for any club organized for business, pleasure, recreation, or other social purposes, or (3) a facility used in connection with any of the above items. Therefore entertainment expenses are completely nondeductible, regardless of whether they are directly related to or associated with the taxpayer's business, unless one of the exceptions in Code Sec. 274(e). ***We strongly advise you to break out a separate "Entertainment" account from previously aggregated "Meals and entertainment" on your trial balance for 2018 and going forward.***

The current 50% limit on the deductibility of business meals is expanded to meals provided through an in-house cafeteria or otherwise on the premises of the employer

For tax years beginning after December 31, 2025, the Act will disallow an employer's deduction for expenses associated with meals provided for the convenience of the employer on the employer's

business premises, or provided on or near the employer's business premises through an employer-operated facility that meets certain requirements.

Credit for family and medical leave

For wages paid in 2018 and 2019, 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 employees are on Family and Medical Leave (FMLA) if the rate of payment is 50% of the wages normally paid to the employees. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the payment rate exceeds 50%. All qualifying full-time employees have to be given at least two weeks of annual paid family and medical leave (all less-than-full-time qualifying employees have to be given a commensurate amount of leave on a pro rata basis).

Cash basis accounting

The cash method of accounting may be used by taxpayers (other than tax shelters) that satisfy a \$25 million gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. This means that taxpayers with annual average gross receipts that do not exceed \$25 million (indexed for inflation for tax years beginning after December 31, 2018) for the three prior tax years are allowed to use the cash method. As under pre-Act law, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the \$25 million gross receipts test, so long as the use of the method clearly reflects income. An accounting method change under this rule is a change in the taxpayer's accounting method for purposes of Code Sec 481.

Accounting for inventory

Any producer or re-seller that meets the \$25 million gross receipts test is exempt from the application of the Code Sec. 263A UNICAP rules. An accounting method change under this rule is a change in the taxpayer's accounting method for purposes of Code Sec. 481.

Long-term contracts

The exception for small construction contracts from the requirement to use the percentage of completion method (PCM) is expanded to apply to contracts for the construction or improvement of real property if the contract: (1) is expected (at the time the contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the tax year in which the contract was entered into) meets the \$25 million gross receipts test.

Use of this PCM exception for small construction contracts is applied on a cut-off basis for all similarly classified contracts (so there is no adjustment under Code Sec. 481(a) for contracts entered into before January 1, 2018).

Qualified business income pass-through deduction

A new deduction for “qualified business income” on pass-through entities begins in 2018. The Act adds a new deduction for noncorporate taxpayers for qualified business income. The deduction is

also referred to as the “pass-through deduction.” The deduction reduces taxable income, rather than adjusted gross income, but is available to taxpayers who take the standard deduction.

In general, the deduction cannot exceed 20% of the excess of the taxpayer's taxable income over net capital gain. The deduction is generally 20% of a taxpayer's qualified business income (QBI) from a partnership, S corporation, or sole proprietorship, defined as the net amount of items of income, gain, deduction, and loss with respect to the trade or business. Certain types of investment-related items are excluded from QBI, e.g., capital gains or losses, dividends, and interest income (unless the interest is properly allocable to the business). Employee compensation and guaranteed payments to a partner are also excluded.

Taxpayers whose taxable income exceeds the threshold amount of \$157,500 (\$315,000 in the case of a joint return) are also subject to limitations based on the W-2 wages and the unadjusted basis in acquired qualified property.

Taxpayers in service related businesses, such as healthcare professionals, law, accounting, actuarial science, performing artists, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees are eligible. However, the deduction for taxpayers in service businesses is phased out if the taxpayer's taxable income exceeds the threshold amount of \$157,500 (\$315,000 in the case of a joint return).

Qualified property must be related to a *qualified trade or business* for a tax year and is tangible property of a character subject to a Code Sec. 167 depreciation allowance.

The depreciable period for qualified property of a taxpayer is the period beginning on the date the property was first placed in service by the taxpayer and ending on the later of (i) the date that is 10 years after that date, or (ii) the last day of the last full year in the applicable recovery period that would apply to the property under Code Sec. 168.



MOVE YOUR COMPANY FORWARD

Lang Allan & Company PC provides accounting, tax, payroll, and financial services to businesses and individuals.

We have worked with many clients in many industries, including (but not all inclusive) construction, real estate, residential and commercial audio/visual, technology, staffing, professional employer organizations (“PEO”), professional services, physician/medical practices, manufacturing, fixed-base operator (“FBO”) and start-ups.

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