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**FEBRUARY 2018**

# A FEW ITEMS CONCERNING INCOME TAXES AFTER 2017

The Tax Cuts and Jobs Act, hailed as the largest tax reform in over 30 years, was signed into law by the President on December 22, 2017. Unlike many previous December tax laws, it makes almost no retroactive changes. It makes profound changes for 2018 and the next few years that are far too extensive for detailed discussion here. A few comments, however, might be of interest.

The reduction in the individual tax brackets and rates (top rate decreased from 39.6% to 37%) will, for many middle and upper-income taxpayers, be offset by the limitation on the state and local tax deductions and the limitation of almost all other itemized deductions except charitable contributions, mortgage interest, and, for 2017 and 2018, medical expenses in excess of 7.5 percent of adjusted gross income. The alternative minimum tax (AMT) for individuals continues with a higher AMT exemption amount.

Business tax changes will result in much more significant tax decreases and will cause a rethinking of tax planning choices between pass-through entities (S corporation, limited liability companies, and partnerships) and C corporations, which do not "pass through" their income to shareholders but rather pay the tax at the corporate entity level. The corporate tax rates, previously with a top 35 percent rate, were significantly reduced to a new flat rate of 21 percent. The top pass-through tax rate continues to be the top individual rate, but a new and very complicated deduction for pass-through income, generally 20 percent of the taxpayer's "qualified business income" from a pass-through LLC, partnership, S corporation or a sole proprietorship, is now available for most businesses. This 20 percent deduction is severely limited, however, for most professional practices and other service businesses where the reputation or skill of one or more employees is the principal asset of the business. As a result, the law after 2017 has three income tax rates applicable to business income; that is, a 21 percent flat rate for C corporations, a 29.6 percent equivalent top rate (80 percent of 37 percent) for pass-through income eligible for the 20 percent qualified business income deduction, and a 37 percent top rate for pass-through income not eligible for the 20 percent qualified business income deduction and for employee salaries.

A few highlights of the Tax Cuts and Jobs Act follow:

- <u>Lower Income Tax Rates and Brackets</u> – The top income tax rate for individuals is now 37 percent plus the 3.8 percent add-on Medicare Tax for investment income, for a combined 40.8 percent, down from 43.4 percent (39.6 percent plus 3.8 percent for 2017).

- Increased Standard Deduction – The deduction is now $24,000 for married individuals on a joint return, $18,000 for head of household filers, and $12,000 for all other individuals.

- Eliminated Personal and Dependent Exemptions – These exemptions are suspended through 2025.

- Modified Kiddie Tax on Unearned Income – This tax computation will now be made using trust tax rates rather than using the parents' top rate.

- Eliminated Personal Casualty and Theft Loss Deductions – These deductions are suspended through 2025.

- Limited State and Local Tax Deductions – The aggregate of these deductions is limited to $10,000 through 2025.

- Limited Mortgage Interest Deduction – For home acquisition loans made during years 2018 through 2025, the interest deduction is limited to the interest on $750,000 of debt ($375,000 for married filing separately). For the same period, the interest deduction for home equity loans (i.e., the proceeds are not used for home purchase or improvement) is eliminated entirely.

- Denied Charitable Contribution – No charitable contribution deduction is allowed where the contribution entitles the taxpayer to purchase tickets or seating at a college athletic event.

- Eliminated Alimony Deduction/Taxable Income – Alimony is not deductible by the payer nor is it taxable to the recipient for divorces or separation agreements after December 31, 2018.

- Suspended Miscellaneous Itemized Deductions – These deductions are suspended through 2025.

- Future Elimination of Affordable Care Act Mandate - Effective January 1, 2019, the penalty tax for failure to maintain minimum essential coverage is eliminated, but it remains effective for 2017 and 2018.

- Modified Individual Alternative Minimum Tax Retained – The individual AMT was retained but with an increased alternative minimum taxable income threshold of $70,300 for single individuals and $109,400 for joint returns.

- Repealed Corporate Alternative Minimum Tax – The corporate minimum tax, which was limited to large corporations, is now eliminated.

- Increased Business Property Expensing – 100 percent cost recovery (expensing) will now be available for certain tangible, personal, new and used property. The depreciation period for certain real property improvements is shortened from 39 years to 15 years.

- Limited Business Interest Deduction – Businesses with gross receipts exceeding $25 million (and those defined as "tax shelters") are subject to a limitation on the deduction of business interest. Exceptions to the limitation are provided for floor plan financing (for dealers selling vehicles, boats, and farm equipment), for electing real property businesses, and for electing farm businesses.

- Limited Net Operating Loss (NOL) Deduction – The NOL deduction generally will be limited to 80 percent of taxable income (down from 100 percent). Also, with some exceptions (e.g., farm losses), the NOL can no longer be carried back to obtain tax refunds from prior years. It can only be carried forward to reduce tax in future years.

- Eliminated Domestic Production Activity Deduction – This deduction has been repealed.
- Limited Like-kind Exchange Treatment – The tax-deferred exchange of like-kind property will now be limited to real estate. For example, the trade-in of a business vehicle will now be a taxable event.
- Restriction on Certain Roth IRA Conversions – The "look back" rule for re-characterization of Roth IRA conversions is repealed.

## 2017 ENFORCEMENT OF LOUISIANA USE TAX

You may recall that in 2016 Louisiana enacted into law a requirement effective July 1, 2017 that out-of-state retailers (Remote Retailers) that do not collect Louisiana sales tax furnish the purchaser and the state with information concerning purchases by Louisiana residents. The Remote Retailer is required, by January 31st of each year, to send to each Louisiana purchaser an annual notice concerning buyer's purchases for the previous year including:

- Total amount paid for purchases in the preceding calendar year;
- Listing of the dates and amounts of the purchases, but not listing the detail of the items or services purchased;
- Whether the property or service is exempt from Louisiana sales tax, if known by the retailer;
- Clear disclosure of the name of the retailer; and
- A clear statement that Louisiana use tax might be due on the purchase made from the retailer and that Louisiana law requires the payment of individual use tax liability on the individual's income tax return or on a Consumer Use Tax Return (Form R-1035).

The notice to the purchaser is required to be sent first class or certified mail or electronically and cannot be included with any other shipment or mailing from the Remote Retailer. If mail is used, the envelope must include the words "Important Tax Document Enclosed."

The first notifications under this new law must be sent to Louisiana purchasers by January 31, 2018. An annual statement must be filed by the Remote Retailer with the Tax Payer Compliance Division of the Louisiana Department of Revenue by March 1st following the year of the sale.

By now you may have received notices issued under this new law. The tax due on these purchases, at nine percent, can be paid with your Louisiana income tax return or it can be separately paid using Louisiana Form R-1035 available on the Internet. Louisiana taxpayers desiring to pay the use tax with their Louisiana income tax returns should include the amount of purchases subject to the use tax with the data submitted to their tax return preparer. Some income tax organizers (ours included, on page1 of the Louisiana section at the back of the organizer) provide a space for reporting taxable purchases.

Louisiana has had a use tax on out-of-state purchases for more than 50 years. Until July 1, 2017, the requirement for accumulating purchases and reporting and paying the use tax was totally on the purchaser. Compliance was very low. Now that the Remote Retailer is required to report names and amounts to the Taxpayer Compliance Division of the Louisiana Department of Revenue and to the purchaser, the burden, at least for Internet transactions, has been shifted in part to the internet Remote Retailer and enforcement by the Department of Revenue will now be cost effective. The Department of Revenue will be able to compare the Remote Retailer reports to the tax returns and issue notices of deficiency with penalties and interest for those not paying the use tax.

## ESTATE AND GIFT TAXES AFTER 2017

After the enactment of the new tax law in December 2017, we have new and significantly increased gift and estate tax lifetime equivalent exemptions, which are (until the next new tax law) scheduled to last until January 1, 2026 when they revert to 2017 levels.

Estate and gift taxes are unified such that a single rate schedule and effective exemption amount apply to an individual's cumulative taxable gifts and bequests. A lifetime unified credit (adjusted annually for inflation) is available for taxable transfers by gift or at death. The unified credit for 2018 effectively exempts from the gift tax and/or the estate tax a total per individual of $11.2 million ($22.4 million for a couple) in cumulative taxable transfers. Transfers above the exemption are taxed at a 40-percent flat rate. The lifetime exemption amount not used at the death of the first of a couple to die is generally available for use by the surviving spouse.

Gift and estate taxes are computed on the fair market value of the property transferred. Most gifts to spouses and to charities are free of gift tax as are annual exclusion gifts (currently up to $15,000 per donor and per donee). The estate tax is imposed on the taxable estate at the time of death. It is to be paid by the decedent's estate and is based on the fair market value of the property included in the taxable estate. The taxable estate generally equals the worldwide gross estate, less certain allowable deductions, including a marital deduction for certain bequests to the surviving spouse and a deduction for bequests to charities. With the use of a marital bequest, payment of death tax can be deferred until the death of the second of the couple to die.

A second, separate transfer tax is imposed on generation-skipping transfers in addition to any estate or gift tax that is normally imposed on such transfers. This tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a beneficiary who is more than one generation below that of the transferor. For 2018, the generation-skipping transfer tax is imposed at a flat rate of 40 percent on generation-skipping transfers in excess of $11.2 million ($22.4 million for a couple).

For those of us who plan to live beyond 2025 (when, without another law change, the lifetime equivalent exemption reverts back to the pre-2018 amount), the currently increased exemption is just an opportunity to make larger tax-free gifts before 2026. For those willing to make such large life-time transfers, the sooner the better so that future appreciation on the gifted property also will be removed from the donor's taxable estate. But, for those living beyond the year 2025 without having made substantial gifts utilizing the increased exemption amounts, the new (and temporary) tax law for gifts and estates will result in no estate tax savings.

Louisiana does not have a gift tax or a death tax.

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# TAKE A LOOK AT THE DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

The domestic production activities deduction (DPAD) provides a tax break for certain "domestic production activities." Unfortunately, many businesses tend to overlook this valuable tax break because they believe it's applicable only to certain industries. In fact, the deduction remains available to a wide range of businesses for the 2017 tax year.

## SIGNIFICANT BENEFITS

Calculating the DPAD is complex. Generally, the deduction is equal to the lesser of 9% (6% for "oil-related" activities) of a company's income from qualified production activities or its taxable income. In addition, the deduction can't exceed 50% of W-2 wages for the year that are attributable to domestic production.

To determine its qualified income, a business needs to start with its gross receipts from qualified domestic production activities and subtract the cost of goods sold and certain other costs allocable to those activities.

## INDUSTRY SPECIFICS

Over the last couple of years, the IRS has issued guidance related to the application of the DPAD to several specific industries. These include:

**Contract manufacturing.** Which party to a contract manufacturing arrangement is entitled to claim the DPAD? Under current rules, the answer depends on which party enjoys the benefits and bears the burdens of ownership. That, in turn, depends on several factors, including which party:

- Retains legal title to manufactured property during production,
- Controls the property and the process,
- Bears the risk of loss or damage,
- Receives profits from the property's sale, and
- Pays property taxes.

To eliminate the uncertainty associated with this analysis, proposed regulations would establish a bright-line test under which the party that actually performs the activity would be entitled to claim the deduction.

**Construction.** Qualified production activities include those associated with the construction or substantial renovation of U.S. real property, including those "typically performed by a general contractor," such

### TREATMENT OF W-2 WAGES UNDER DPAD

The IRS has provided guidance on the W-2 wage limitation to taxpayers with a short taxable year as it applies to the domestic production activities deduction. Wages are calculated on a calendar-year basis, and there had been some uncertainty over the treatment of wages paid during a short tax year that didn't include a calendar year end. Temporary regulations provide that wages paid to employees during such a short tax year are included for the purposes of the W-2 wage limitation.

The temporary regulations also clarify the treatment of wages when a business is acquired or disposed of during the year. If employees receive wages from two different taxpayers, those wages are allocated between the taxpayers based on the employees' respective periods of employment with each taxpayer.

as management and oversight of the construction process. Proposed regulations would clarify that a contractor whose activities are limited to approving and authorizing invoices and payments is ineligible for the DPAD.

**Testing and packaging.** Under current rules, qualified production activities may include testing of component parts, packaging, repackaging, labeling and "minor assembly." Proposed regulations would exclude these activities if the taxpayer isn't otherwise involved in manufacturing, producing, growing or extracting the property in question.

### ASSISTANCE AVAILABLE

If your business has claimed the DPAD before, or if you think you may be able to for the 2017 tax year, please contact us. We can assist you with both the calculations involved and compliance with IRS rules. ■

## MAKING 2017 RETIREMENT PLAN CONTRIBUTIONS IN 2018

The clock is ticking down to the tax filing deadline. The good news is that you still may be able to save on your impending 2017 tax bill by making contributions to certain retirement plans.

For example, if you qualify, you can make a deductible contribution to a traditional IRA right up until the April 17, 2018, filing date and still benefit from the resulting tax savings on your 2017 return. You also have until April 17 to make a contribution to a Roth IRA.

And if you happen to be a small business owner, you can set up and contribute to a Simplified Employee Pension (SEP) plan up until the due date for your company's tax return, including extensions.

### DEADLINES AND LIMITS

Let's look at some specifics. For IRA and Roth IRA contributions, the maximum regular contribution is $5,500. Plus, if you were at least age 50 on December 31, 2017, you are eligible for an additional $1,000 "catch-up" contribution.

There are also age limits. You must have been under age 70½ on December 31, 2017, to contribute to a traditional IRA. Contributions to a Roth can be made regardless of age, if you meet the other requirements.

For a SEP, the maximum contribution is $54,000, and must be made by the April 17th date, or by the extended due date (up to Monday, October 15, 2018) if you file a valid extension. (There's no SEP catch-up amount.)

### PHASEOUT RANGES

If not covered by an employer's retirement plan, your contributions to a traditional IRA are not affected by your modified adjusted gross income (MAGI). Otherwise, when you (or a spouse, if married) are active in an employer's plan, available contributions begin to phase out within certain MAGI ranges.

For married couples filing jointly, the MAGI range is $99,000 to $119,000. For singles or heads of household, it's $62,000 to $72,000. For those married but filing separately, the MAGI range is $0 to $10,000, if you lived with your spouse at any time during the year. A phaseout occurs between AGI of $186,000 and $196,000 if a spouse participates in an employer-sponsored plan.

Contributions to Roth IRAs phase out at mostly different ranges. For married couples filing jointly, the MAGI range is $186,000 to $196,000. For singles or heads of household, it's $118,000 to $133,000. But for those married but filing separately, the phaseout range is the same: $0 to $10,000, if you lived with your spouse at any time during the year.

### ESSENTIAL SECURITY

Saving for retirement is essential for financial security. What's more, the federal government provides tax incentives for doing so. Best of all, as mentioned, you still have time to contribute to an IRA, Roth IRA or SEP plan for the 2017 tax year. Please contact our firm for further details and a personalized approach to determining how to best contribute to your retirement plan or plans. ■

## DO YOU KNOW THE TAX IMPACT OF YOUR COLLECTIBLES?

They say one person's trash is another person's treasure. This may hold true when it comes to collectibles — those various *objets d'art* for which many people will pay good money. But if you're considering selling or donating some of your precious items, be sure to consider the tax impact on your 2017 return.

### SALES

The IRS views most collectibles, other than those held for sale by dealers, as capital assets. As a result, any gain on the sale of a collectible that you've had for more than one year generally is treated as a long-term capital gain.

But while long-term capital gains on many types of assets are taxed at either 15% or 20% for the 2017 tax year, capital gains on collectibles are taxed at 28%. (As with other short-term capital gains, the tax rate when you sell a collectible that you've had for one year or less typically will be your ordinary-income tax rate.)

Determining the gain on a sale requires first determining your "basis" — generally, your cost to acquire the collectible. If you purchased it, your basis is the amount you paid for the item, including any brokers' fees.

If you inherited the collectible, your basis is its fair market value at the time you inherited it. The fair market value can be determined in several ways, such as by an appraisal or through an analysis of the prices obtained in sales of similar items at about the same time.

### DONATIONS

If you want to donate a collectible, your tax deduction will likely depend both on its value and on the way in which the item will be used by the qualified charitable organization receiving it.

For you to deduct the fair market value of the collectible, the donation must meet what's known as the "related use" test. That is, the charity's use of the donated item must be related to its mission. This probably would be the case if, for instance, you donated a collection of political memorabilia to a history museum that then puts it on display.

Conversely, if you donated the collection to a hospital, and it sold the collection, the donation likely wouldn't meet the related-use test. Instead, your deduction typically would be limited to your basis.

### PROPER HANDLING

There are a number of other rules that may come into play when selling or donating collectibles. Our firm can help you handle the transaction properly on your 2017 return. ■

## WHEN AN ELDERLY PARENT MIGHT QUALIFY AS YOUR DEPENDENT

It's not uncommon for adult children to help support their aging parents. If you're in this position, you might qualify for an adult-dependent exemption to deduct up to $4,050 for each person claimed on your 2017 return.

### BASIC QUALIFICATIONS

For you to qualify for the adult-dependent exemption, in most cases your parent must have less gross income for the tax year than the exemption amount. (Exceptions may apply if your parent is permanently and totally disabled.) Social Security is generally excluded, but payments from dividends, interest and retirement plans are included.

In addition, you must have contributed more than 50% of your parent's financial support. If you shared caregiving duties with one or more siblings and your combined support exceeded 50%, the exemption can be claimed even though no one individually provided more than 50%. However, only one of you can claim the exemption in this situation.

### IMPORTANT FACTORS

Although Social Security payments can usually be excluded from the adult dependent's income, they can still affect your ability to qualify. Why? If your parent is using Social Security money to pay for medicine or other expenses, you may find that you aren't meeting the 50% test.

Also, if your parent lives with you, the amount of support you claim under the 50% test can include the fair market rental value of part of your residence. If the parent lives elsewhere — in his or her own residence or in an assisted-living facility or nursing home — any amount of financial support you contribute to that housing expense counts toward the 50% test.

### EASING THE BURDEN

An adult-dependent exemption is just one tax break that you may be able to employ on your 2017 tax return to ease the burden of caring for an elderly parent. Contact us for more information on qualifying for this break or others. ■