CORNER STONE
CPA GROUP LLP

TAX REFORM UPDATE

Tax Update for Business Owners July 2018

The Highly Anticipated "20% Deduction"

Section 199A

You may have heard of one of the most valuable parts of the new tax reform that is affecting business owners—the Section 199A 20% Deduction. In short, this new deduction will allow many business owners (not including C corp owners) to take a deduction on their 2018 personal tax return for the lesser of 20% of their business profits or 20% of taxable income (less net capital gains). This can generate great tax savings for business owners. Most married-filing-joint (MFJ) taxpayers whose taxable income for the year is $315,000 or less ($157,500 or less if single), will be able to utilize the 20% deduction for 2018. However, if taxable income from the business is above those thresholds or there are other losses on the tax return, then this 20% deduction may be limited or eliminated altogether.

Limitations on the 20% Deduction

There are various limitations on the 20% deduction and guidance on various grey areas in the tax law is forthcoming. For instance, we are waiting on guidance from the IRS to find out if owners can use the 20% deduction for rental income.

For a MFJ taxpayer whose qualified business income (profit) is over $415,000 ($207,500 for a single taxpayer), the deduction is limited to 50% of the business' W-2 wages for the year. (If the business has minimal or zero W-2 wages, there is an alternative calculation based on the cost of certain business assets.)

However, for professional service firms whose primary asset is the knowledge of the owner or its employees (such as legal firms, accounting firms, consulting firms) then the deduction is completely eliminated if the firm's owner makes over $415,000 in his or her share of the profits, regardless of the wages paid.

Another key factor to the new deduction is that the owner's personal W-2 wages or guaranteed payments from the business are excluded from business income in calculating the 20% deduction. So a large W-2 or guaranteed payment to the owner may limit the 20% deduction. It may be advantageous to reduce owner wages and take distributions instead. (However, remember that S corporation owners are required to take a reasonable wage each year and the IRS may increase oversight of this requirement given this new deduction.)

This is only a brief overview of the 20% deduction and our best attempt to summarize a complex law onto one page. Please call our office if you would like to discuss this new deduction further and look at tax planning to maximize the benefit of this deduction in 2018.

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- New interesting 529 Education Plan Rules
- 2018 Tax Brackets and important figures

Should I Change My Business Entity Type Based on New Tax Reform?

New Tax Rates for C Corporations

You may have heard that the new tax rate for corporations is a flat, and supposedly permanent, 21%. This has caused many business owners to wonder if they should change their business entity type from an S Corporation, partnership, or sole proprietorship (Schedule C) to a C Corporation.

Although this may be a good option for a few businesses, we don't anticipate many businesses will change to a C corp—even in light of the new lower tax rate. This is mainly due to the fact that owners are still taxed when they pull money out of C corps, whereas they are usually not taxed when they take money out of S corps, partnerships, and sole proprietorships.

For example, if a C corp made a profit for the year and the owner took those profits out of the company, the profits would be taxed 21% at the corporate level and then another 23.8% on the owner's personal tax return (if the owner is in the highest tax bracket). This comes to a total Federal tax rate of 44.8%. When you compare this 44.8% to the maximum tax rate of 37% that S corps, partnerships, and sole proprietor's pay (if they are owned by individuals), it makes switching to a C corp seem like a less valuable option.

However, if a business makes high profits each year and the owners do not wish to take them out of the business, then a C corp may be a good option.

Changing between an S Corp, Partnership, and Sole Proprietorship

The new 20% deduction is another factor that may affect which business entity a business would select. S corporations are required to have reasonable owner wages, which hurts the "20% deduction", whereas partnerships are not required (so far) to have reasonable owner wages.

However, partnerships must pay self-employment tax on all their income (up to the FICA limits) whereas S corp owners only pay self-employment tax on their wages. So this may reduce the benefit of changing from a partnership or sole proprietorship to an S corp.

In summary, at this point most businesses are keeping their entity type the same even in light of the new tax law; however there are some businesses where change could be beneficial. If you would like to discuss the potential benefits of changing your entity type, give us a call.

Entertainment Expenses Completely Disallowed

Under new tax reform, there is no longer a tax deduction for entertainment expenses. This means that any entertainment, even if it has a 100% business purpose, will not be deductible on your tax return.

This change might make business owners think twice before buying tickets or season passes for their favorite sports events, and instead find other ways to advertise and promote business.

New Estate Exclusion Doubled

The estate exclusion for 2018 has increased to $11,180,000 (so a married couple would get to exclude $22,360,000). This is more than double the exclusion for 2017.

This new exclusion may be hugely beneficial for you if you have an estate worth $5 million or more (or $10 million for a married couple), and you are willing to gift a large amount of your estate now to either an individual or a trust.

We would certainly recommend talking with us and with your attorney to find out if you should take action before this tax law changes again.

The reason this is so important is that many estates will have to pay almost 50% tax on the value of their estate that exceeds the exclusion — a 50% tax on money that has already been taxed!

Draft of 2018 "Postcard" Form 1040

The IRS has issued a draft of what the 2018 Form 1040 may look like. Although they have made the new 1040 the size of a postcard, that is only because they have added 6 new schedules to attach to the form. You can check out the draft yourself at https://www.irs.gov/pub/irs-dft/f1040--dft.pdf

Form 1040 Simplified — Department of the Treasury—Internal Revenue Service — U.S. Individual Income Tax Return — 2018

Your first name and initial | Last name

Standard deduction: ☐ Someone can claim you as a dependent ☐ You were bo

Spouse or qualifying person's first name and initial (see inst.) | Last name

Standard deduction: ☐ Someone can claim your spouse as a dependent ☐ You

☐ Your spouse is ... nd ☐ You

Home address (number and street). ... a P.O. box, see ... ons.

City, town or post office, state, and ZIP code. If you have a foreign address, attach Sched

DRAFT

Benefits of Paying Wages to Your Kids

For 2018, the standard deduction for a single person has been raised to $12,000. This means that parents who own businesses can pay each of their kids up to $12,000 in wages federally tax-free and get a business tax deduction for it.

This benefit is even greater for kids under age 18 because owners don't have to pay Social Security, Medicare, or Federal Unemployment on their kids' wages who are under age 18 (If they own a husband/wife partnership or sole proprietorship). This is over 15% in tax savings in payroll taxes alone.

If your kids save their wages and use it for college, it's essentially like the parents are deducting their kids' college tuition as a business expense!

Important note: *Don't be fooled by the picture on the right. The IRS does not allow you to pay your kids a wage unless they actually work in the business. So the wages you pay them need to be substantiated by a timecard or something to prove they earned their wage.*

This newsletter provides business, financial, and tax information to clients and friends of our firm. This general information should not be acted upon without first determining its application to your specific situation. For further details on any article, please contact us.

529 Education Plans May Now Be Used for K-12

Before recent tax reform, 529 Education Plans were only allowed to be used for college expenses. Starting in 2018, taxpayers can use money from 529 plans to pay for K-12th grade expenses as well. Since most 529 plans get state tax benefits and therefore cost states tax revenue, many states (including Michigan) are still deciding if they will allow their 529 plans to be used for K-12 expenses.

Indiana recently reported that they will allow their 529 plans to be used for K-12 and for college expenses starting 1/1/18. However, for 2018, they are reducing the tax credit for 529 contributions which will be used for K-12 expenses down to $500. However, if you contribute money for both K-12 expenses and college expenses in 2018, then your maximum credit could still be $1,000. Then in 2019 and forward, the maximum credit will return to $1,000, whether you use the money to pay for K-12 or college expenses. This Indiana law change is fairly confusing, so please contact us if you would like guidance on how much to contribute to your 529 in 2018.

These 529 plans can be very beneficial because the earnings on the plans are not taxed by Federal or State government when used for qualified education expenses. In addition, many states give nice tax credits or deductions for contributions to state-sponsored 529 plans.

Important 2018 Tax Numbers

- **2018 Standard Deduction**
  Married Filing Joint/Qualifying Widower- $24,000
  Head of Household - $18,000
  Single/Married Filing Separately - $12,000
- **2018 Personal Exemption Amount -** $0
  (Tax reform eliminated the personal exemption.)
- **2018 Bonus Depreciation** - You may expense 100% of eligible new OR used assets in 2018
- **2018 Section 179 Depreciation Limits** - $1 million
- **2018 Child Tax Credit Maximum -** $2,000
  (this is doubled from 2017)
- **2018 IRA Contribution Limits** - Up to $5,500
  (add $1,000 if age 50+)
- **2018 HSA Contribution Limits** - $3,450 for individual
  - $6,900 for family
  (add $1,000 if age 55+)
- **2018 Standard Mileage Rates**
  Business - $0.545
  Charitable - $0.14
  Medical/Moving - $0.18
- **2018 Annual Gift Tax Exclusion** - $15,000
- **2018 Unreimbursed Employee Expenses allowed**- $0!
  (In prior years, a W-2 employee could deduct his or her unreimbursed job expenses on his or her tax return. These expenses are no longer deductible. Therefore, we recommend employers reimburse their employees for all reasonable job expenses since employers may still deduct them.

Contact Us

Please feel free to call our office or email our staff with questions. We want to be a helpful resource for you.

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New 2018 Tax Brackets

Below are the tax brackets in 2018. The 2018 rates are all lower than 2017's tax rates of 10%, 15%, 28%, 33%, 35%, and 39.6%

Rate	Individuals	Married Filing Jointly
10%	Up to $9,525	Up to $19,050
12%	$9,526 to $38,700	$19,051 to $77,400
22%	38,701 to $82,500	$77,401 to $165,000
24%	$82,501 to $157,500	$165,001 to $315,000
32%	$157,501 to $200,000	$315,001 to $400,000
35%	$200,001 to $500,000	$400,001 to $600,000
37%	over $500,000	over $600,000