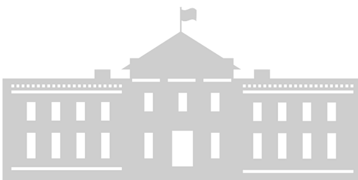
Cora Capital Advisors 2018 Tax Brief

Finally, a single piece of legislation was released which merged together the differences in tax reform from both the House and Senate. This tax brief highlights the changes that would affect pass through entities, known as S Corporations, LLC Partnerships, and Sole Proprietorships. This brief is not meant to be a comprehensive look at the Act,



but a rundown of the major points that impact our individual clients. This data, provided by Baratz & Associates, P.A., is for informational purposes only.

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Quick Comparison of Conference Bill and Current Law

☑	Item of Interest	Current Law		Conference Bill 2018
	Alternative Minimum Tax	Individual: 26, 28% Corp: 20%	⬇	Exemption Increased
	Top Corporate Rate	35%	⬇	21%
	Pass-through income	Same as individual rates	⬇	20% deduction

IN GENERAL--20% of qualified business income is deductible. Qualified business income = taxable profit before the new deduction. So, in situations where this new deduction is unlimited, effectively 80% of taxable profit is taxed at the individual's marginal rate and 20% of taxable profit is taxed at 0%.

The new deduction is applicable for income tax purposes only, as it is not a deduction for self-employment tax purposes. This new 20% deduction is unlimited for taxpayers with taxable income below the following thresholds: $315,000 joint return and $157,500 all other individuals. But limitations apply.

For ALL businesses –except for "Specified Services," **the 20% deduction is generally limited** above the $315,000 (joint); $157,500 (single/HH/MFS) taxable income thresholds to the Lesser of:

20% of taxable profit of the business

OR

the greater of:

50% of (Form W-2) Wages paid to employees

OR

25% of (Form W-2) Wages paid to employees

PLUS 2.5% of Original Cost Basis of Depreciable property

The limitations apply to most professional service businesses where the principal asset is the reputation or skill of employees & owners. For these businesses, the new 20% deduction will be phased-out beginning when taxable income of the individual professional exceeds the following thresholds:

$315,000 joint return--totally phased-out @ $415,000

$157,500 single/HH/MFS--totally phased-out @ $207,500

Doctors, lawyers, accountants, dentists, consultants, financial/ investment managers, advisors, brokers, etc. are all included in the "specified services" phase-out and will not gain any benefit from this new deduction when their individual taxable income exceeds $415,000 (joint), $207,500 (single/HH/MFS).

For individuals in multi-owner S corporations or LLC/Partnerships, the Schedule K-1 allocations of income and deduction items will be combined to determine the individual's taxable profit (loss) from each entity for the year. Additionally, the Schedule K-1s's will have to allocate the individual owner's % share of:

a.) W-2 wages paid to employees for the year and

b.) Original cost basis of depreciable property, so that the limitation calculations can be done at the individual return level.

It appears that net losses from business activities of a taxpayer will offset net profits from his or her other activities whereby a deduction will occur only from an overall net taxable profit. Under current law, U.S. manufacturing, production and construction activities are allowed a 9% deduction---this deduction is repealed after 12/31/17 because of the new 20% deduction available to all businesses.

KEY TAKEAWAYS

"Pass-thru" income tax rates are reduced by as much as 10 percentage points in 2018. For business/real estate profit eligible for an unlimited 20% deduction under the new law; the effect of the new deduction is a tax rate reduction from the 39.6% maximum rate for 2017 to 29.6% for 2018. (37% max * 80% = 29.6% effective). However, much of this tax reduction may only serve to offset the tax increase resulting from the new $10,000 limitation in state and local tax deductions—especially those living and doing business in NJ. We will assist you in this analysis.

Starting in 2018, the federal income tax rates for salary & bonuses (Form W-2 income) will be higher than the tax rates for business & rental profit. For example, for joint returns with taxable income above $600,000, subject to the new maximum 37% tax rate, the income tax rate on additional compensation will be 37% versus 29.6% on additional business/rental profit, in cases where the new deduction is unlimited. This differential is in addition to the employment taxes that are assessed on W-2 income. We can assist our business clients in reviewing their family salary arrangements to determine whether they can be reasonably reduced starting in 2018 and whether salary reductions are advantageous overall.

Rental Real Estate businesses- the 2.5% of original cost basis provision allows rental real estate businesses to take advantage of this new deduction, without having any employees. However, it appears that land cost is excluded. In situations where business operators own real estate in LLCs and their operating entity pays rent to their LLC, a tax disadvantage may occur if excessive rent causes a limitation to the new 20% deduction. We can assist our clients in reviewing their self-rental arrangements to determine whether rent can be reasonably reduced starting in 2018 and whether a rent reduction would be advantageous.

C corporation federal tax rates are reduced from the 35% maximum rate for 2017 to 21% starting in 2018. In certain situations, it will be advantageous for business owners to change their entity choice to a C Corporation. We can assist our business owner clients in reviewing their existing entity choices for their operating businesses, to determine whether their current business characteristics and future plans, including exit strategy, could result in tax advantages from electing to become a C corporation.

Starting in 2018, the federal income tax rates for Form W-2 income will be higher than the tax rates for independent contractors (Form 1099/Sch C). We can assist our individual tax clients in determining whether switching to independent contractor status would be appropriate.⌘