



FINANCIAL PLANNING REVIEW

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UNDERSTANDING TWO KEY PROVISIONS IN THE TAX CUTS AND JOBS ACT

Much has been written about the new tax act, and we've been inundated with emails and newsletters explaining the changes. To help you cut through the clutter, we'll review two provisions receiving the most attention:

1

Limiting deductibility of state and local taxes (SALT) to a maximum of \$10,000 (for married couples)

2

The more complex 20% tax break for pass-through entities

SALT is particularly onerous for those living in high-tax states like California, New York, and New Jersey. Many legislatures in those states are now considering ways to “reclassify” the tax payments so they would still be deductible. It will be interesting to watch how creative lawmakers get in trying to circumvent the SALT cap.

It is too soon to know how the housing industry will be affected by SALT, along with a new cap of \$750,000 on loans for the mortgage interest deduction. That cap had been \$1 million for mortgages, with an additional deduction on up to \$100,000 in home equity loans. (Note: Homeowners with loans in place prior to December 15, 2017, are grandfathered in.)

Because deductions for mortgage interest and property taxes are one of the big advantages of home ownership, the new law could negatively affect property owners, especially those with high-priced homes. They could see their taxes increase and property values decrease, as potential buyers will have fewer incentives to own an expensive home.

The increased standard deduction is another nuance of the law that could affect real estate purchases and prices. Many taxpayers may now opt to claim the standard deduction instead of itemizing, therefore making mortgage interest and property taxes less of an advantage.

The tax break for pass-through entities is not as straightforward. Most small businesses are structured as pass-through entities such as a limited liability company (LLC), sole proprietorship, partnership, or S corporation. In these entities, net income is passed through to the owners and reported on their individual tax return. This was an advantage when personal tax rates were lower than the corporate rate, but it may no longer be now that corporate taxes have been reduced from 35% to 21%. For this reason, Congress included in the new legislation a 20% deduction for qualified business income (QBI).

There are many rules governing the QBI deduction as well as limitations for certain businesses in the fields of health, law, accounting, consulting, financial services, performing arts, actuarial science, athletics, brokerage services, securities

investing/trading, and any business whose principal asset is the reputation or skill of one or more of its employees or owners. The deduction phases out for owners in these fields with high income:

- **Joint filers:** Deduction phases out between **\$315,000 and \$415,000** of taxable income.
- **All other filers:** Deduction phases out between **\$157,500 and \$207,500** of taxable income.

These taxable income amounts exclude the 20% deduction for QBI. Other, more complicated rules also apply when calculating the deduction. Suffice it to say that CPAs will be faced with interpreting the law and asking the IRS for guidance. Finally, it’s important to note that this 20% tax break is not permanent — it expires after 2025.

Visit our blog at sfginc.com to read more about the new tax cuts and job acts, plus other relevant, timely articles or give us a call to discuss your situation at (775) 850-5620.

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