

THE BRADLEY BURNETT **FEDERAL TAX**

UPDATE

2018

By Bradley Burnett

J.D., LL.M. (Taxation)

**New and
Comprehensive
Reference for
Preparing 2018
Returns in the
2019 Busy
Season**



Bradley Burnett Tax Seminars, Ltd.

2018 Federal Tax Update

(Complete with Tax Cuts and Jobs Act)

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Chapter 1 Individual

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Individual

Proposed 2018 Tax Legislation

Tax Reform 2.0

- Comprised of three tax bills
- House passed all three in 2018
- All three likely dead on arrival in Senate

Tax Reform 2.0

- Protecting Family and Small Business Tax Cuts Act (HR 6760)
- Would make individual and §199A tax changes (that otherwise expire in 2025) permanent
- Including individual rate cuts, SALT cap, lost personal exemptions and most other TCJA individual changes
- Would cost \$631 billion over 10 years
- Would require 9 democrat senator's votes (highly unlikely w/ SALT cap extension)
- At best, a snowball's chance down south

Tax Reform 2.0

- American Innovation Act (HR 6756)
- Would consolidate start up and organizational expense rules
- Would allow \$20,000 current deduction in year active trade or business begins
- Remainder amortized over 180 months (15 years)
- Start up NOLs and credits retained even after §382 ownership change
- Would cost \$5.4 billion over 10 years

Tax Reform 2.0

- Family Savings Act (HR 6757)
- Would add Universal Savings Accounts (USAs):
- Allow \$2,500 annual after-tax contributions for any tp w/ "compensation income"
- No income limit on contribution
- Tax-free withdrawals used for anything (not just retirement)
- Structure similar to IRAs (institutional trustee, no life insurance, no collectibles, etc.)

Tax Reform 2.0

- Family Savings Act (HR 6757) (cont.)
- Would exempt from required minimum distributions (RMDs) of IRA (or retirement plan) if balance no exceeds \$50,000
- Would allow traditional IRA contributions after age 70 ½
- New parents (birth or adoption) could w/draw up to \$7,500 from retirement accounts penalty free
- Would allow §529 plan owners to distribute for apprenticeship programs and home school expenses (curriculum, books, online materials, tutoring and dual enrollment fees)
- Would cost \$8.6 billion over 10 years

Sequestration (Reduction of Govt Payments)

- IRS payments reduced by mandatory sequestration (6.2% payment reduction) (FY Oct 2018 – Sept 2019) (BBA 2018, Balanced Budget and Emergency Deficit Control Act of 1985)

Sequestration (Reduction of Payments) (in Millions)			
	Before	Rate	After
C Corp MTC (Min. Tax Credit)	\$520 M	6.2%	\$32 M
Small Business Health Insurance Credit	17 M	6.2%	1 M
Whistleblower Awards	32 M	6.2%	2 M
Private Debt Collector	30 M	6.2%	2 M

Ministers – Gifts vs. Income

- §61, 102 Unsolicited Donations to Minnesota Pastor Not Gifts (*Wayne Felton*, TCM 2018-168 (10/10/18))
- Holy Christian Church, St. Paul, MN pastor’s receipts:

Reverend Felton’s Salary vs. Donations		
	2008	2009
Salary	\$40,000	\$40,000
Parsonage Allowance	78,000	78,000
Blue Envelope Donations*	258,000	\$234,000

* Blue envelope donations = Nondeductible donations made directly to pastor, collected (w/out sales pitch) at church, later handed over directly to pastor (no church knowledge or accounting of amounts)

Ministers – Gifts vs. Income

- Payments to minister could go either way
- Gift* = Detached and disinterested generosity – Out of affection, respect, admiration or like impulses (*Duberstein* (US S Ct 1960))
- Gift*: (*Mutch* (3rd Cir. 1954)) – Payments to retired minister after health problems = Gifts – No expectation of future services

Ministers – Gifts vs. Income

- Payments to minister could go either way
- Income: (*Terrell* (5th Cir. 1985)) – Large, ongoing gifts to active minister who declared no salary – Income taxable (criminally prosecuted for income tax evasion)
- Income: (*Goodwin* (8th Cir. 1995)) – “Special occasion” gifts 3 times/year organized by, pitched by and accounted for by church, 1/3 of active minister’s annual receipts

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Ministers – Gifts vs. Income

- (*Wayne Felton*, TCM 2018-168 (10/10/18)) – Tax Court ruled “blue envelope” receipts taxable income, not gifts
 - Court looked to objective, not subjective, evidence
 - Blue envelope gifts in expectation of future services
 - Minister not retired (continuing to provide services)
 - Organized (though no heavy handedly pitched) by church
 - Amount quite substantial compared to modest salary
 - This case was a closer call than some, but above did minister in

Ministers – Gifts vs. Income

- Is a payment to a minister a gift or income?
 1. Depends on facts and circumstances
 2. It sure does smell like income if:
 3. Significant portion of minister’s receipts
 4. Organized, administered by church
 5. Minister still providing services for church
 6. It appears to casual observer minister is being compensated (objective standard)
- Beware criminal

Ministers – Gifts vs. Income

- Ex: Church provides envelopes once a year (pitches once) to congregants for “gifts” to church employees. \$2,400 total, split 8 ways (\$300/ee). How taxed?
 - A. It’s only \$300 (worry about football instead)
 - B. It’s de minimis, so categorically ignore
 - C. There is no de minimis rule for cash, so W-2 taxable
 - D. Think of the afterlife where all is divinely forgiven

Minister Housing Allowance

Minister Housing Allowance

- §107 Re-Tooled and Re-Loaded Lawsuit Shoots Down Parsonage Allowance Exclusion on Constitutional Grounds (*Freedom From Religion Foundation, et al (Annie Laurie Gaylor, et al), v. Lew (Mnuchin)*, Case No. 16-cv-215-bbc (WD WI (12/13/17))
- §107(2), not §107(1), violates Establishment Clause of First Amendment to United States Constitution

Minister Housing Allowance

- (*Gaylor v. Mnuchin*), (WD WI (12/13/17)) (cont.)
- **§107(2)**, not §107(1), **violates** Establishment Clause of 1st Amendment to United States Constitution
- §107 For a minister, gross income does not include:
 - 1) Rental value of a home furnished in-kind as part of comp (§107(1)); or
 - 2) **rental allowance paid in cash as part of comp**, to extent used to rent or provide a home and to extent such allowance does not exceed fair rental value of home, including furnishings and appurtenances

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such as a garage, plus cost of utilities (§107(2))

Minister Housing Allowance

- Advice to clergy: File your returns without delay
- §107(2) parsonage exclusion for cash allowance remains available for 2017 tax returns for now
- Case on appeal to 7th Circuit (appeal filed 02/08/18)
- Trial court ruled §107(2) exclusion remains available for 180 days after final resolution of case
- Thus, §107(2) cash allowance may remain safe for 2018 or longer - We'll have to see
- §107(1) not under siege for now

Disability Income for Veterans

Combat-Injured Veterans Tax Fairness Act of 2016 (P.L. 114-92)

- U.S. combat injured veterans are allowed to recover income taxes improperly withheld by the Department of Defense (DOD) on certain disability payments. DOD is directed to identify any such payments made after 01/17/91.
- Statute of limitations to claim refund is one year after date letter received from DOD

Tax Cuts and Jobs Act

- Tax Cuts and Jobs Act now law and reality
- Biggest change in 31 years
- Treasury and IRS guidance skimpy at best so far
- 2018 Technical Corrections Bill? Badly needed
- Timing? Don't hold your breath
- Might get Technical Corrections as part of next Bill to fund operation of government

Tax Reform

“The difference between death and taxes is death doesn't get worse every time Congress meets.”

Will Rogers

Tax Cuts and Jobs Act

- Q: Are individuals and companies better off or worse off after Tax Reform?
- A: It depends on who you are
- Must line up each taxpayer with each specific new TCJA provision and project impact of each and overall

Tax Cuts and Jobs Act (H.R. 1)

- After initially naming H.R. 1 the “Tax Cuts and Jobs Act”, Congress deleted such name at final passage
- Now, H.R. 1 is “the apparently nameless legislation formerly known as the ‘Tax Cuts and Jobs Act’ ”
- Also known as P.L. 115-97 (12/22/17)
- Congress ultimately titled it “H.R. 1 – An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018”

2018 Federal Tax Update

- We'll just call it "TCJA" or "the artist formerly known as 'Prince'"

Tax Cuts and Jobs Act

- TCJA is true tax reform
- Not just rate cuts
- Broadens tax base by stripping away or limiting formerly available tax breaks
- Narrows tax base on rare occasion by adding new tax breaks
- Throttles back indexing for inflation to slower pace

TCJA – Blue Book

- Tax Notes Today on 10/10/18 reported rumor that 2017 Tax Cuts Jobs Act Blue Book is floating around in bowels of IRS
- Yet, we in the free world, are yet to see a copy
- Blue Book = After-the-fact legislative history written by Joint Committee on Taxation

Tax Cuts and Jobs Act

- TCJA is law today, but the political winds of change often blow ... and (if and) when they do ...
- Though part of TCJA is only temporary, portions may be made permanent later
- Though part of TCJA is permanent, portions may be repealed sooner than later
- Portions of TCJA may be changed before take effect
- Thus, grab it now while it's good (if it's good)

Tax Cuts and Jobs Act – Shelf Life

- What is shelf life of TCJA?
- Many (individual) provisions 2018-2025
- Many business provisions permanent
- Various other provisions oddball start and end times
- What is the half-life of TCJA?
- Federal elections roll around every 2 years
- Will the tide turn or not?

Tax Cuts and Jobs Act

- Income tax rates for 2018 (and in the near future) are at lowest in decades
- Timing the receipt of income into 2018 (and next few years) appears to be a great move
- The current crazy low tax rate window may not last for long
- Approach timing of income and other items for each taxpayer case-by-case

TCJA – Comparing Top Income Tax Rates

2018 Federal Tax Update

Top Tax Rates Under Tax Cuts and Jobs Act		
Type of Tax	Prior (2017)	TCJA
Individual (2018-2025)	39.6%	37%
Adj Net LT Cap Gains / Qualifying Dividends	23.8%	23.8%
Pass-Through (2018-2025)	39.6%	29.6%
Corporate (after 2017)	35%	21%

TCJA - Individual Income Tax Rates (Single)

Brackets* - Single	TCJA (2018-2025)
\$0 - 9,525	10%
\$9,525 - 38,700	12%
\$38,700 - 82,500	22%
\$82,500 - 157,500	24%
\$157,500 - 200,000	32%
\$200,000 - 500,000	35%
\$500,000** and up	37%

* Brackets indexed for inflation more slowly than prior law (permanent change)

** Marriage penalty applies only in top bracket

TCJA - Individual Income Tax Rates (HH)

Brackets* - Head of Household	TCJA (2018-2025)
\$0 - 13,600	10%
\$13,600 - 51,800	12%
\$51,800 - 82,500	22%
\$82,500 - 157,500	24%
\$157,500 - 200,000	32%
\$200,000 - 500,000	35%
\$500,000** and up	37%

* Brackets indexed for inflation more slowly than prior law (permanent change)

** Marriage penalty applies only in top bracket

2018 Federal Tax Update

TCJA – Individual Income Tax Rates (MFJ)

Brackets* – Married Filing Jointly / SS	TCJA (2018-2025)
\$0 - 19,050	10%
\$19,050 - 77,400	12%
\$77,400 - 165,000	22%
\$165,000 - 315,000	24%
\$315,000 - 400,000	32%
\$400,000 - 600,000	35%
\$600,000** and up	37%

* Brackets indexed for inflation more slowly than prior law (permanent change)

** Marriage penalty applies only in top bracket

TCJA – Individual Income Tax Rates (MFS)

Brackets* – Married Filing Separately	TCJA (2018-2025)
\$0 – 9,525	10%
\$9,525 – 38,700	12%
\$38,700 – 82,500	22%
\$82,500 – 157,500	24%
\$157,500 - 200,000	32%
\$200,000 - 300,000	35%
\$300,000** and up	37%

* Brackets indexed for inflation more slowly than prior law (permanent change)

** Marriage penalty applies only in top bracket

2018 Wage Withholding

- All new 2018 Wage Withholding Tables (IRS Notice 1036 (Revised January 2018))
- Reflect TCJA changes
- Employers must use by 02/15/18
- Employees need not change W-4s
- IRS is revising online tax calculator (at IRS.gov) (promised by end of Feb. 2018) and W-4

2018 Federal Tax Update

TCJA – Underwithholding or Underpayment of Estimated Tax

- Under TCJA, many taxpayers will be:
 - Underwithheld; or
 - Underpaid in estimated tax
- **Warning**
- **Interest rate on underpayment of taxes increased from 3% to 5% in early 2018**

2018 Wage Withholding

- Paycheck Checkup = Special alert for key groups to diagnose withholding to avoid surprises (IR-2018-80 (04/02/18))
 - Two-income family
 - Work two or more jobs
 - Only work for part of year
 - Have children and claim credits such as child tax credit
 - Have older dependents, including children age 17 or older

2018 Wage Withholding

- Paycheck Checkup - Special alert for key groups to diagnose withholding to avoid surprises (IR-2018-80 (04/02/18))
 - Personal circumstance changes
 - Itemized deductions on 2017 return
 - Received large tax refunds or had large tax bills for 2017
 - Earn high incomes and complex tax returns

2018 Wage Withholding

- Don't forget to thump and squeeze state withholding
 - TCJA causing havoc w/ state income tax liabilities
 - Examples: If state computes state income tax based on federal formula, then:
 1. If fed eliminates deduction, it may be cut for state purposes as well
 2. Not itemizing deductions anymore could increase state taxes

TCJA – Effect on Estimated Taxes

- Taxpayer-by-taxpayer projections should be made to project effect of TCJA on each taxpayer for estimated tax purposes

TCJA – Effect on Estimated Taxes

- Taxpayer-by-taxpayer projections should be made to project effect of TCJA on each taxpayer for estimated tax purposes
 - For taxpayers with business income, accounting method changes could have huge impact on 2018 estimated tax payments. If business goes accrual to cash, would owe \$1 mil. less tax in 2018. Q: Pay less estimated tax during 2018?
 - Problem: Waiting on related IRS guidance for §481(a) adjustment guidance

TCJA – Effect on Estimated Taxes

- New TCJA excess loss limitation (New §461(l))

2018 Federal Tax Update

- Beginning in 2018, business operating loss allowed only to extent of \$250,000 (non-MFJ), \$500,000 (MFJ)
- Excess business loss (over \$250,000 (or \$500,000)) is disallowed currently, becomes NOL carryforward
- This new limit could hit hard for tp w/ large current year business loss and large current year non-business income
- Also could limit availability of freed up passive activity loss (PAL)

Rates – Before and After TCJA

Rates (Top Rates) Before and After TCJA		
Type of Tax or Rate	Prior Law (2017)	TCJA (After 2017)
Individual Income	39.6%	37%
Supplemental Pay W/H Rate	25%	22%
Backup Withholding	28%	24%
Non-Corp Adj. Net Cap Gains	20%	20%
Estate and Trust Income	39.6%	37%
C Corp Income	35%	21%

Backup Withholding

- In response to TCJA, backup withholding rate drops from 28% to 24% (effective 01/01/18) (under §3406, the 4th lowest rate under §1(c))
- Taxpayers who fail to file tax returns and fail to cooperate with IRS may experience backup withholding
- IRS notifies payers of income to taxpayer to withhold and directly remit to IRS 24% of all payments to taxpayer
- Payments include pay to contract labor or investment income e.g., interest or dividends

Kiddie Tax

Is kiddie tax more or less expensive under TCJA?

- More expensive
- Less expensive
- Finally, kids are free to be just kids

Kiddie Tax Basics

- Kiddie tax applies to child:
 - Under age 18 (age 24 if full-time student);
 - With unearned income over \$2,100; and
 - Who does not file joint return
- Kiddie tax applies to net unearned income (NUI) of child > \$2,100
- Remainder of child's income (earned and unearned) taxed at child's otherwise applicable rates

TCJA – Kiddie Tax

- Kiddie tax before TCJA (2017)

2018 Federal Tax Update

- Child's NUI > \$2,100 taxed at parent(s)' rates
- Kiddie tax during TCJA (2018-2025)
- Child's NUI > \$2,100* taxed at estate/trust rates
- Kiddie tax after TCJA (2026 and later)
- Child's NUI > \$2,100* taxed at parent(s)' rates * Indexed for inflation

Kiddie Tax – Prior (2017) / TCJA (2018-2025)

Prior (2017)	TCJA (2018-2015)
Net unearned income of child > \$2,100 taxed at parent(s)' rates* if parents' rates higher than child's (*ord. and cap gains)	Net unearned income of child > \$2,100 taxed at rates* applicable to trusts and estates (*ord. and cap gains)
- Remainder of child's taxable income taxed at child's rates	- Remainder of child's taxable income taxed at child's rates
- Child's tax affected by tax posture of parent(s) (and un-earned income of sibling(s))	- Child's tax unaffected by tax posture of parent(s) (and un-earned income of sibling(s))

TCJA Kiddie Tax – Effect on Tax Practice

- Effect of TCJA kiddie tax on tax practice
 1. Tax return preparation
 2. Tax prep fees
 3. Planning advice

TCJA Kiddie Tax – Effect on Tax Practice

1. Tax return prep – New protocol (2018-2025)
 - If child's NUI > \$2,100, child's separate Form 1040 mandatory
 - Reporting child's income on parent(s)' return no longer possible
 - No delay reporting of child's income pending parent(s)' return

TCJA Kiddie Tax – Effect on Tax Practice

2. Tax preparation – Fee applies to child (2018-2025)
 - In prior years, if child's income reported on parent(s)' 1040, tax prep fee billed to parent
 - Parent(s) viewed high tax prep fee to child as distasteful and self-defeating
 - Under TCJA, child's kiddie tax return mandatory (if NUI high enough) - Thus, tax prep fee applies to child
 - How to handle this with your allocation pencil?

TCJA Kiddie Tax – Effect on Tax Practice

3. Planning advice for TCJA kiddie tax (2018-2025)
 - Is conventional (2017) "kiddie tax planning" thinking still appropriate?
 - It depends
 - Stay tuned (see later slides in this slide deck)

TCJA – Kiddie Tax (Estate and Trust) Rates

2018 Federal Tax Update

Estate & Trust / Kiddie Tax Brackets (2018)	Ordinary Income (OI) Rates - TCJA (2018-2025)
\$0 – 2,550	10%
\$2,551 – 9,150	24%
\$9,151 – 12,500	35%
\$12,501 and up	37%

- Child's net unearned income taxed at trusts and estates brackets* (*for each OI and capital gains)
- Child's tax no longer affected by tax situation of child's parent(s) and sibling(s)

TCJA –Estate and Trust Rates – Ordinary Income

Prior Law (2017)		TCJA (2018-2025)		Difference
OI Brackets	OI Rates	OI Brackets	OI Rates	Savings
\$0 – 2,550	15%	\$0 – 2,550	10%	\$128
2,551-6,000	25%	2,551 – 9,150	24%	66
6,001-9,150	28%			126
9,151-12,500	33%	9,151 – 12,500	35%	(67)
12,501 & up	39.6%	12,501 and up	37%	2.6% x excess

Estates and trusts pay less income tax under TCJA. Up through the 35% bracket, the net tax savings per estate (or trust) is \$253. Beginning with the 37% bracket, the savings is 2.6%.

For Ordinary Income, Is Kiddie Tax
Higher or Lower Under TCJA?

- Does new kiddie tax cost more or less under TCJA?
- For ordinary income (OI), **depends on parent(s)' income**
 - TCJA kiddie tax **better deal for high income parents**
 - TCJA kiddie tax **worse deal for low income parents**

Kiddie Tax – Higher or Lower Under TCJA?

Kiddie Tax on OI - Prior Law vs. TCJA - Parents (MFJ) Top Rate			
Child's Net Un-earned Income	Parents (2017) (39.6% Bracket)	TCJA Kiddie Tax (2018)	TCJA Savings (Cost)
\$1,000	\$390	\$100	\$290
5,000	1,980	843	1,137
10,000	3,960	2,136	1,824
12,500	4,950	3,012	1,938
20,000	7,920	5,787	2,133
50,000	19,800	16,887	2,913

When parents in highest bracket, TCJA kiddie tax at all income levels because various tax rate brackets
 Kiddie Tax – Higher or Lower Under TCJA?

Kiddie Tax – TCJA (2018) – Parents (MFJ) Top (37%) Bracket			
Child's Net Un-earned Income	Parents (2018) (37% Bracket)	TCJA Kiddie Tax (2018)	TCJA Savings (Cost)
\$1,000	\$370	\$100	\$270
5,000	1,850	843	1,007
10,000	3,700	2,136	1,564
12,500	4,625	3,012	1,613
20,000	7,400	5,787	1,613
50,000	18,500	16,887	1,613

When parents (MFJ) in 37% bracket, kiddie tax at all levels of income under TCJA because various tax rate brackets

Kiddie Tax – Higher or Lower Under TCJA?

Kiddie Tax – TCJA (2018) – Parents (MFJ) in 10% Bracket			
Child's Net Un-earned Income	Parents (2018) (10% Bracket)	TCJA Kiddie Tax (2018)	TCJA Savings (Cost)
\$1,000	\$100	\$100	\$0
5,000	500	843	(343)
10,000	1,000	2,136	(1,136)
12,500	1,250	3,012	(1,762)
19,050	1,905	5,435	(3,530)

This free preview courtesy CPA Trendlines. Learn more and purchase at <https://cpatrendlines.com/shop/bb18ftu/>

2018 Federal Tax Update

When parents (MFJ) in 10% bracket, it always costs more to h/ > \$2,100 net unearned income in child's, not parents', name

Kiddie Tax – Higher or Lower Under TCJA?

Savings/Cost of Kiddie Tax – TCJA (2018) – Parents (MFJ)							
Child's NUI	Parents' Bracket / Savings (Cost)						
	10%	12%	22%	24%	32%	35%	37%
\$1,000	\$0	\$20	\$220	\$240	\$220	\$250	\$270
5,000	(343)	(243)	257	357	757	907	1,007
10,000	(1,136)	(936)	64	264	1,064	1,363	1,564
12,500	(1,762)	(1,512)	(262)	(12)	988	1,363	1,613
20,000	(3,530)	(3,387)	(1,387)	(987)	613	1,363	1,613
50,000	N/A	(10,887)	(5,887)	(4,887)	(887)	613	1,613
BE Pt.*	None	2,763	10,427	12,031	32,260	None	None

* Child's net unearned income (NUI) breakeven point where TCJA kiddie tax more expensive than parents' NUI (this example ignores NIIT)

Kiddie Tax on OI – Higher/Lower Under TCJA?

- Kiddie tax on ordinary income (OI) better for wealthy under TCJA* (*but only for 8 years (2018-2025))
- Main reason: Tax rates lower
- Provides lower set of brackets for each child
- Kiddie tax costly for non-wealthy (or wealthy in low income years) under TCJA*
- Child's brackets ratchet up faster than do parent(s)'

Capital Gains Rates (Non-Corporate)

Capital Gains* Rates (Non-Corporate)

2018 Federal Tax Update

	2017			2018 - 2025		
	0%	15%	20%	0%	15%	20%
MFJ / SS	\$0- 75,900	\$75,901- 470,700	Over \$470,700	\$0- 77,200	\$77,201- 479,000	Over \$479,000
HH	\$0- 50,800	\$50,801- 416,700	Over \$416,700	\$0- 51,700	\$51,701- 452,400	Over \$452,400
Single	\$0- 37,950	\$37,951- 418,400	Over \$418,400	\$0- 38,600	\$38,601- 425,800	Over \$425,800
MFS	\$0- 37,950	\$37,951- 235,350	Over \$235,350	\$0- 38,600	\$38,601- 239,500	Over \$239,500
Estate /Trust	\$0- 2,550	\$2,551- 12,500	Over \$12,500	\$0- 2,600	\$2,601- 12,700	Over \$12,700

* Same rates apply for qualified dividends

Kiddie Tax on Capital Gains Income – Higher or Lower Under TCJA?

- Does new kiddie tax cost more or less under TCJA?
- For adjusted net capital gain income, tax rates stay same under TCJA as under prior law
- Thus, tax savings under TCJA not as dramatic
- For parents in 37% bracket, new kiddie cap gain tax rate structure (on first roughly \$12,700 cap gain) helpful
- For parents in lower brackets, new kiddie cap gain tax rate structure (escalating to higher rates quickly) costly

NIIT – Investment by Parent vs. Child

- As to investing by parents vs. child, also consider effect of 3.8% NIIT tax
- TCJA does not directly affect NIIT
- NIIT applies tax return by tax return
- Better for child, not parent(s), to have income (gets own \$200,000 NIIT exemption)
- Otherwise, parent(s) get(s) only one \$250,000 (MFJ), \$200,000 (Single/HH), \$125,000 (MFS) NIIT exemption

Parent vs. Child Investing

- Unearned income sources
- FLP or FLLC (child owns interest in family partnership)
- Trust (child owns beneficial interest in trust) (receives taxable income for portion distributed)
- UTMA (Uniform Trust for Minors) and UGMA (Uniform Gifts to Minors)
- §529 (defers tax currently)
- IDGT (Intentionally Defective Grantor Trust) (grantor pays income tax to dwindle value of estate)

Parent vs. Child Investing

- Question: Pay TCJA kiddie tax or go §529 plan?
- Many factors to consider
- If choose current taxation, may contribute funds to state law UTMA or UGMA account
- Current tax route may net 0%, 15% and 20% rates on cap gains and qualified dividends

2018 Federal Tax Update

- §529 plan avoids current income tax, but has long term strings on usage (or else penalty)
- Mix and match (outside and inside §529) hedges risks
- Answer lies in your view of the future

Parent vs. Child Investing

§529	Pay TCJA Kiddie Tax
If no school, roll to other kid	Attend school not relevant
How expensive is school? How much to sock away & avoid penalties later?	If no interest in school, does kid want to start a business?
Asset protected in Fed Bankruptcy	Not generally asset protected
Owner of account may access funds	Owner no access if gave it away
How good are available investments?	Broader range of investments

Parent vs. Child Investing

§529	Pay TCJA Kiddie Tax
Defer income tax on earnings	Currently pay tax on earnings
May get state income tax deduction for contrib (immediate rate of return)	State income tax deduction (if any) for §529 contribution not available
May avoid cost of prep of child tax return	May trigger cost of prep of child tax return
Draws taxed as ordinary income (OI)	OI or capital gains (qual. div.) rates
Penalties if kid no attends school	Attend school not relevant

Parent vs. Child Investing

- How does TCJA kiddie tax structure ultimately affect parent vs. child investing?
 - Income in child's name **saves taxes** for **high income parents**
 - **High income in child's name** costly for **lower income parents**
 - For low income parents, consider change in how to invest (e.g., invest in growth assets w/ lower current taxable income, §529, etc.)

Parent vs. Child Investing

But, remember, TCJA version of kiddie tax scheduled to expire after 8 years (after 2025)

Capital Gains Rates (Non-Corporate)

Capital Gains* Rates (Non-Corporate)

2018 Federal Tax Update

	2017			2018 - 2025		
	0%	15%	20%	0%	15%	20%
MFJ / SS	\$0- 75,900	\$75,901- 470,700	Over \$470,700	\$0- 77,200	\$77,201- 479,000	Over \$479,000
HH	\$0- 50,800	\$50,801- 416,700	Over \$416,700	\$0- 51,700	\$51,701- 452,400	Over \$452,400
Single	\$0- 37,950	\$37,951- 418,400	Over \$418,400	\$0- 38,600	\$38,601- 425,800	Over \$425,800
MFS	\$0- 37,950	\$37,951- 235,350	Over \$235,350	\$0- 38,600	\$38,601- 239,500	Over \$239,500
Estate /Trust	\$0- 2,550	\$2,551- 12,500	Over \$12,500	\$0- 2,600	\$2,601- 12,700	Over \$12,700

* Same rates apply for qualified dividends

Top Investment Income Tax Rates

Type	Prior Law*	NII	Prior Combined	TCJA	NII	TCJA Combined	Change
Qual. Div.	21.2	3.8	25	20	3.8	23.8	(1.2)
Adj. LTCG	21.2	3.8	25	20	3.8	23.8	(1.2)
Nonqual Dividend	40.8	3.8	44.6	37	3.8	40.8	(3.8)
STCG	40.8	3.8	44.6	37	3.8	40.8	(3.8)
Interest	40.8	3.8	44.6	37	3.8	40.8	(3.8)
Rents, Royalties	40.8	3.8	44.6	37	3.8	40.8	(3.8)

* Includes 1.2% increase in marginal rate as result of Pease reduction of itemized deductions under prior law

TCJA - Standard Deduction

Filing Status	Prior (2017)	TCJA (2018-2025)
Single	\$6,350	\$12,000*
HOH	\$9,350	\$18,000*
Married (MFJ)	\$12,700	\$24,000*

2018 Federal Tax Update

1. Indexed for inflation after 2018
2. Over age 65, additional standard deduction (SD): \$1,600 (Single); \$1,300 (MFJ) each
3. Over age 65, additional standard deduction (SD): \$1,600 (Single); \$1,300 (MFJ) each

TCJA - Percent of Itemizers

Filing Status	Prior (2017)	TCJA (2018-2025)
Single	16.7%	8.5%
HOH	17.3%	6.0%
Married (MFJ)	44.1%	16.3%
Overall	26.4%	10.9%

Source: Tax Policy Center Table 2018-1: Impact on Number of Itemizers of H.R. 1 (01/11/18)

Standard Deduction Planning

- Planning: Wise use of standard deduction
- Bunching strategy - Play leapfrog every other year (heavy itemized one year, light the next)
 - In “heavy” itemized year, itemized goes higher
 - In “light” year, standard deduction
 - After 2017, bunching most capably done w/ charitable contributions for tps w/ \$15,000 or less home mortgage interest

Standard Deduction Planning

- Bunching strategy - Play leapfrog every other year (heavy itemized one year, light the next)
 - Heavy charitable contributions 2017, light 2018, heavy 2019 & so on
 - In “light” itemized year, gap between itemized and standard deduction (SD) allowed (full SD allowed)
 - Creates legitimate “phantom” deduction
 - Example: In 2018, itemized deductions only \$10,000. Standard deduction \$24,000. Full \$24,000 standard deduction allowed.

Standard Deduction Planning

- Bunching of contributions greatly facilitated by a donor advised fund
 - Donor advised fund (DAF) = A philanthropic vehicle set up and operated through a public charity to which donors make currently deductible charitable contributions and may recommend grants from contributed funds over time
 - Example: Scott Community Foundation sets up DAF. Harold makes heavy dose of contributions to DAF in 2018, doled out over 2018 and subsequent years

Standard Deduction Planning

- Bunching of contributions greatly facilitated by a donor advised fund (DAF)
- Contributions to donor advised fund
 - Cash contributions limited to 60% of AGI
 - Long term capital gain property limited to 30% of AGI
 - DAFs may accept cash, mutual funds, real estate, etc.

2018 Federal Tax Update

- When DAF runs out of funds, donor can reload it

Standard Deduction Planning – No DAF vs. DAF

	2018	2019	2020
Charitable Contribution – No DAF	\$12,000	\$12,000	\$12,000
SALT	\$10,000	\$10,000	\$10,000
Total Itemized	\$22,000	\$22,000	\$22,000
Standard Deduction	\$24,000	\$24,000	\$24,000
Itemized Deductions Allowed	\$0	\$0	\$0
Charitable Contribution w/ DAF	\$36,000	\$0	\$0
SALT	\$10,000	\$10,000	\$10,000
Total Itemized	\$46,000	\$10,000	\$10,000
Standard Deduction	\$24,000	\$24,000	\$24,000
Itemized Deductions Allowed	\$22,000	\$0	\$0

Standard Deduction Planning

- Standard deduction deductible for regular tax, but not for alternative minimum tax (AMT), purposes
- Enter all itemized deductions into tax prep software (regardless of whether standard deduction allowed for regular tax purposes or not) so that itemized deductions allowed against AMT will offset AMT
- Which itemized deductions are allowed against AMT?

Standard Deduction Planning

- Which itemized deductions allowed against AMT?
- Medical expenses > 7½% AGI
- Home mortgage acquisition debt interest
- Charitable contributions
- Investment interest expense to extent of AMT investment income (private activity bond income)
- Gambling losses to extent of gambling winnings

TCJA – Personal Exemption Deduction

Deduction for Personal Exemptions		
	Prior Law (2017)	TCJA (2018-2025)
Exemption	\$4,050	\$0

TCJA increases child tax credit and adds new family tax credit feature to child tax credit