



R E Duncan & Company, CPA
2826 Philadelphia Drive
Dayton, Ohio 45405

Phone:937-275-3992 Fax:937-275-3772 Email: redcpa85@aol.com

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Dear Client:

We have been busy analyzing the new tax laws and their impact on our clients. There have been significant changes for the business owner and individual taxpayers. And just to make this tax season even more interesting the Internal Revenue Service has also issued a new Form 1040 to be used in 2019 for 2018 tax returns.

Our goal is to meet with business clients to determine the effect of the new tax laws on your business. This may mean looking at the tax treatment of the business to see if we need to change your corporation type (either an S corporation or C corporation). For most pass-thru entities; sole proprietorships, partnerships and S corporations; there is a new tax benefit that may provide a reduction in taxable income on your individual income tax return.

For individual taxpayers the standard deduction has been increased and many of the Schedule A deductions have been eliminated with the intent to simplify the tax return. Personal exemptions have also been eliminated but the child tax credit has been increased and there is a new, nonrefundable credit of \$500 for other dependents on your tax return.

For those of you considering divorce, the alimony deduction will be gone if the divorce is not finalized prior to January 1, 2019 and the alimony is not taxable income to the person receiving it.

There have also been significant changes to the deduction for taxes (real estate taxes, state income tax and/or sales tax) as well as the mortgage interest deduction.

We have explored some of these topics in more depth in this newsletter. Contact us on how these new tax provisions and other changes in the Tax Cuts and Jobs Act may affect you.

Tax Cuts and Jobs Act

The new tax law, commonly called the "Tax Cuts and Jobs Act," is the biggest federal tax law change in over 30 years. Below are some significant changes affecting individuals and businesses. Except where noted, the changes are effective for tax years beginning after December 31, 2017.

While we have included the most popular provisions, be sure to contact our office to see how these, and other provisions of the Tax Cuts and Jobs Act, may affect you.

Individual Tax provisions that were eliminated:

- Personal exemption deductions are suspended.
- Phase-out of itemized deductions based on adjusted gross income (AGI) is suspended.
- Itemized deduction for home equity interest (other than acquisition debt) is no longer allowed.
- Itemized deduction for miscellaneous itemized deductions subject to the 2% floor are no longer allowed. Examples include investment expenses, unreimbursed employee business expenses, and tax preparation fees.
- Personal casualty loss and theft deductions are eliminated unless the loss is incurred in a federally declared disaster area.
- The moving expense deduction and income exclusion is allowed only to members of the Armed Forces (or their spouses or dependents).
- No charitable contribution deduction is allowed for a payment to a higher educational institution in exchange for the right to purchase tickets or seating at an athletic event.

- Alimony is not deductible by the payer nor includible in income by the recipient for agreements entered into after December 31, 2018.
- Effective for 2019, the shared responsibility payment under the Affordable Care Act for not having minimum essential health insurance coverage is zero.

Individual Tax provisions that were reduced:

- The 2018 individual income tax brackets are reduced with the top bracket at 37%
- The home mortgage interest deduction debt limit is reduced to \$750,000 (\$375,000 MFS) with certain exceptions.
- The itemized deduction for state and local taxes is limited to \$10,000 (\$5,000 MFS). (This limit includes both state and local income taxes and real property taxes.)
- The threshold for deducting medical expenses is 7.5% of AGI for all taxpayers for 2017 and 2018.

Individual Tax provisions that were increased:

- The 2018 standard deduction is:
 - Single or Married Filing Separate..... \$12,000
 - Married Filing Joint or Qualified Widow(er) \$24,000
 - Head of Household..... \$18,000
- The Child Tax Credit increased to \$2,000 per qualifying child and the phase-out threshold increased.
- There is a new Family Tax Credit of up to \$500 for dependents who are not a qualifying child for purposes of the Child Tax Credit.

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New Deduction For Business Owners

One of the more complex changes from the Tax Cuts and Jobs Act is the ability to reduce taxable individual income for those who receive income from a pass-through business entity such as a sole proprietorship, partnership, S corporation or trust/estate. Recipients of income from one of these business entities may be able to reduce their tax liability with this new deduction. The calculation for the reduction in taxable income is based on the lower of 20% of the taxable income from the business or 20% of their individual taxable income. However, the final deduction takes into consideration the amount of individual taxable income and the type of business.

This deduction has been called the qualified business income deduction (QBID) or the 20% pass-through but is formally known as Code Section 199A.

In general, to qualify for the full deduction, your taxable income must be below

\$157,500 if you're single or \$315,000 if file a joint return. Filers who are below those thresholds may take the deduction no matter what business they are in.

If the business is a 'specified service trade or business' then the deduction is not available for joint returns with income greater than \$415,000 or \$207,500 for all others.

A specified service trade or business is defined as being in one of the following professions: health, law, accounting, actuarial science, financial services, brokerage services or a business where the principal asset is the reputation or skill of the owner.

It is possible that two partners or shareholders in the same business may end up with different deduction amounts depending on their marital status and the income of their spouse if filing a joint return.

There are key decisions that business owners may need to make about the type of tax entity. Are you better off staying as a sole proprietorship or S corporation or is now the time to think about treating the business as a C corporation for tax purposes?

Contact our office to set up a time to review your business entity, look at the potential tax liabilities based on your business type and net income, and the effect on your individual income tax return.

Are you better off staying as a sole proprietorship or S corporation or is now the time to think about treating the business as a C corporation...

Tax Cuts and Jobs Act *continued from page 1*

- The 2018 alternative minimum tax (AMT) exemption and phase-out ranges are increased.
- For the charitable contribution deduction, the percentage of AGI limitation for cash to public charities and certain other organizations increased from 50% to 60%.
- The estate and gift tax exemption amount increased to \$11,180,000.

Individual Tax provisions that were changed:

- The long-term capital gain and qualified dividend income maximum tax brackets no longer follow the tax brackets for regular income tax purposes.
- The parent's rate is no longer used to calculate the kiddie tax. Instead, taxable income attributable to net unearned income is taxed at the estates and trusts tax rates for both ordinary income and net capital gains.

Business provisions that were changed:

- Section 199A deduction is effective as of January 1, 2018. Sole proprietorships, partnerships, and S

corporations may be eligible for some or all of the new 20% deduction of qualified business income.

- Expenses related to charity golf tournaments were 100% deductible if you discussed business before, during, or after the event. These expenses are no deductible as an ordinary and reasonable business expense.
- Business meals (with clients and prospective clients) directly related to a trade or business were 50% deductible. However, under the present interpretation of the law these are no longer deductible. We are waiting for further clarification on this issue.
- Business meals when traveling or for staff (which were 100% deductible) are now 50% deductible.
- Entertainment which was directly related to the trade or business were 50% deductible, they are now no longer deductible. This includes for example, tickets to sporting events or the theatre or golf fees.
- Hobby expenses are no longer deductible as the entire section of the Schedule A subject to the 2% threshold has been eliminated.

- Section 179 expensing of business assets has increased to \$1 million per year with the phase-out beginning at \$2.5 million. As in prior years, qualifying property includes both new and pre-owned assets.
- The 2018 alternative minimum tax (AMT) has been eliminated for corporations.
- Transportation fringe benefits are still tax-free to employees for parking, public transportation and bicycle expenses, however, they are no longer a business deduction for employers.
- Bonus depreciation is now 100% and available for both new and pre-owned equipment. It must be new to the taxpayer, therefore, property exchanged in a Section 351 transfer of assets or personal assets placed into a sole proprietorship are not eligible for bonus depreciation (but still eligible for Section 179).
- Section 1031 exchanges are no longer allowed for personal or business property, only for real property.
- C corporation tax rates are now a flat 21% for all businesses regardless of services or products offered.

Do You Have a HOBBY or a BUSINESS?

The Tax Cuts and Jobs Act has eliminated the deduction of expenses for a hobby with the change to the Schedule A (which eliminates the entire section of expenses subject to the 2% threshold).

This has made the determination of whether you are engaged in a business or hobby even more critical. In the past, certain hobby expenses were deductible to the extent that there was income. Unlike an entity that is considered a for-profit business in which the expenses can exceed income, hobby expenses were only allowed to the extent of reported income.

In determining whether an activity is a hobby or business, we consider all facts and circumstances of the activities. Following are some items that are considered when making the determination:

- 1. The manner in which the taxpayer carries on the activity:** Factors that may indicate a business include maintaining books and records, obtaining business licenses, having a website, conducting the activity similar to other businesses, and changing operating methods and techniques to improve profitability.
- 2. The expertise of the taxpayer or their advisors:** Factors that may indicate a business includes the knowledge of the taxpayer (or their consultants) about the industry.
- 3. The time and effort expended by the taxpayer in carrying on the activity:** If you commit a considerable amount of time and effort in the activity, especially if there is no substantial personal or recreational aspect, is considered. Taking time away from another occupation may also indicate a profit motive. Spending little time may not be counted against you if there are employees qualified to conduct the business activity.
- 4. The expectation that assets used in the activity may appreciate in value:** Even if no profit is made from operations, if the value of land or other assets in the activity appreciate so that an overall profit is made from a sale, the activity may be considered a business.
- 5. The success of the taxpayer in carrying other similar or dissimilar activities:** If you were successful in the past turning

an unprofitable venture into a profitable venture, the current activity may be a business even if it has not yet made a profit.

- 6. The taxpayer's history of income or losses with respect to the activity:** Early losses during the start-up phase is to be expected, however, continued losses that are not explainable may indicate a hobby.
- 7. The amount of occasional profits, if any, which are earned:** The amount of profits in relation to the amount of losses, and in relation to your investment in the activity, may indicate intent. An occasional small profit one year, mixed with large losses in other years or large taxpayer investments, may indicate the activity is a hobby. Substantial occasional profits mixed with frequent small losses or investment may indicate a business. An opportunity to earn substantial ultimate profits in a highly speculative venture also indicates a profit motive.
- 8. The financial status of the taxpayer:** If you do not have substantial income or capital from other sources, there may be a profit motive. If you have substantial income from other sources, and losses from the activity in question generate substantial tax benefits, you may not be considered to have a profit motive.
- 9. Elements of personal pleasure or recreation:** Where there are recreational or personal elements involved with the activity, a lack of profits may indicate a hobby. On the other hand, a lack of any appeal in the activity other than possible profits indicates a profit motive. It is not necessary that the sole purpose for engaging in an activity is to make a profit. The availability of other investments that might produce a higher rate of return will not count against the taxpayer. The fact that you derive personal pleasure in the activity is not sufficient in itself to classify the activity as a hobby if other factors indicate the activity is a business.

Occasional profits from hobby activities are not subject to self-employment tax and are reported as other income on Form 1040. Under the Tax Cuts and Jobs Act, for tax years 2018–2025, expenses related

to hobby income are not deductible as miscellaneous itemized deductions subject to the 2% AGI limit on Schedule A (Form 1040).

Activities Not Engaged in for Profit

IRS examiners consider the following in their analysis to determine whether or not an activity is engaged in for profit:

- Are there activities with large expenses and little or no income?
- Are losses offsetting other income on the tax return?
- Does the activity result in a large tax benefit to the taxpayer?
- Does the history of the activity show that it is generating any profit in any years?

Examples of possible hobby activities include:

- Airplane Charter
- Artists
- Auto Racing
- Boating
- Bowling
- Collecting
- Cooking
- Craft Sales
- Direct Sales
- Dog Breeding
- Entertainers
- Farming
- Fishing
- Fishkeeping
- Gambling
- Games
- Gardening
- Horse Breeding
- Horse Racing
- Jewelry Making
- Knitting
- Motocross Racing
- Music
- Outdoor Recreation
- Photography
- Rentals
- Stamp Collecting
- Woodworking
- Writing
- Yacht Charter

Burden of Proof

IRS rules state that if an activity is profitable in three of the last five tax years, including the current year, the presumption is it is carried on for profit, and the hobby loss limitations do not apply. The burden of proof is on the IRS to show the activity is not a business. If the activity consists primarily of breeding, training, showing, or racing horses, the IRS will presume it is carried on for profit if a profit is produced in at least two of the last seven tax years, including the current year. If the activity shows a loss in three of the last five tax years, then the burden of proof is on the taxpayer to show that the activity is a business and not a hobby.

The rules in this area are complex. We encourage you to contact our office if you have any questions regarding your business activities and how to avoid your activities possibly being reclassified as a hobby.

IRS Working on a New Form 1040 for the 2019 Tax Season

As part of a larger effort to assist taxpayers, the Internal Revenue Service plans to streamline the Form 1040 into a shorter, simpler form for the 2019 tax season.

The new 1040—about half the size of the current version—would replace the current Form 1040 as well as the Form 1040A and the Form 1040EZ. The IRS circulated a copy of the new form and is working with the tax community to finalize the streamlined Form 1040. You will see the new streamlined version of the Form 1040 when your 2018 individual income tax return is prepared during the 2019 tax filing season.

This new approach will simplify the 1040 so that all 150 million taxpayers can use the same form. The new form consolidates the three versions of the 1040 into one simple form. At the same time, the IRS will still obtain the information from each taxpayer needed to determine their tax liability or refund.

The new Form 1040 uses a “building block” approach, in which the tax return is reduced to a simple form. That form can be supplemented with additional schedules if needed. Taxpayers with straightforward tax situations would only need to file this new 1040 with no additional schedules.

There are several additional new schedules that have been developed to supplement the new Form 1040. These new schedules will include the lines for other income, adjustments, credits and other items generally included on the longer version of the Form 1040.

The new schedules are designated by numbers instead of letters, and

here’s a quick overview of what the new schedules are for:

- **Schedule 1** is for taxpayers with additional sources of income (not from a W-2) or adjustments to income, such as IRA contributions, student loan interest, and health savings account contributions.
- **Schedule 2** is a form for people with some other forms of taxes, such as alternative minimum tax or excess advance premium tax credit repayment.
- **Schedule 3** is for nonrefundable tax credits such as the foreign tax credit, education credits or residential energy credit.

- **Schedule 4** is where taxpayers will add up certain taxes, such as self-employment tax, uncollected Social Security and Medicare taxes, and household employment taxes.
- **Schedule 5** is to add up tax payments, such as estimated tax payments or amounts paid with an extension.
- **Schedule 6** is where you can report a foreign address or appoint a third-party designee to discuss your tax return with the IRS on your behalf.

Contact us if you have any questions about the new tax forms or any other changes to the tax laws.

Form 1040 (2018) Department of the Treasury - Internal Revenue Service (99) **2018** OMB No. 1545-0071 HS Use Only - Do not write or stamp in this space.

Filing status: Single Married filing jointly Married filing separately Head of household Qualifying widow(er)

Your first name and initial: _____ Last name: _____ Your social security number: _____

Your standard deduction: Someone can claim you as a dependent You were born before January 2, 1954 You are blind

If joint return, spouse's first name and initial: _____ Last name: _____ Spouse's social security number: _____

Spouse standard deduction: Someone can claim your spouse as a dependent Spouse was born before January 2, 1954 Full-year health care coverage or exempt (see inst.)

Spouse is blind Spouse files on a separate return or you were dual-status alien

Home address (number and street). If you have a P.O. box, see instructions. Apt. no. Presidential Election Campaign (see inst.) You Spouse

City, town or post office, state, and ZIP code. If you have a foreign address, attach Schedule E. If more than four dependents, see inst. and check here

Dependents (see instructions)		(7) Social security number	(8) Relationship to you	(9) If qualifies for (see inst.):	
(1) First name	Last name			Child tax credit	Credit for other dependents
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>
				<input type="checkbox"/>	<input type="checkbox"/>

Sign Under penalties of perjury, declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information provided to the preparer by taxpayer.

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1 Wages, salaries, tips, etc. Attach Form(s) W-2

2a Tax-exempt interest

3a Qualified dividends

4a IRAs, pensions, and annuities

5a Social security benefits

6 Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22

7 Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 36, from line 6

8 Standard deduction or itemized deductions (from Schedule A)

9 Qualified business income deduction (see instructions)

10 Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-

11 a Tax (see inst.) (check if any Form: 1 Form 8811 2 Form 4972 3

b Add any amount from Schedule 2 and check here

12 a Child tax credit/credits for other dependents b Add any amount from Schedule 3 and check here

13 Subtract line 12 from line 11. If zero or less, enter -0-

14 Other taxes. Attach Schedule 4

15 Total tax. Add lines 13 and 14

16 Federal income tax withheld from Forms W-2 and 1099

17 Refundable credits: a EIC (see inst.) b Sch 8812 c Form 8863

18 Add any amount from Schedule 5

19 Refund **19** If line 18 is more than line 17, subtract line 17 from line 18. This is the amount you overpaid.

20a Amount of line 19 you want refunded to you. If Form 8888 is attached, check here

b Routing number c Type: Checking Savings

d Account number

21 Amount of line 19 you want applied to your 2019 estimated tax **21**

22 Amount you owe. Subtract line 18 from line 15. For details on how to pay, see instructions **22**

23 Estimated tax penalty (see instructions) **23**

Go to www.irs.gov/Form1040 for instructions and the latest information.

Form 1040 (2018)