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PODCAST EPISODE #14: MYTHS AND REALITIES OF THE NEW TAX BILL INTERVIEW WITH JEFF GROFF, CPA, TAX PARTNER TRANSCRIPT

Kae Wagner – Jeff Groff, thanks for meeting with me today. I know we've had a very interesting end to the year 2017 with the passing of the Tax Code and I know you have lots of information that you're going to share with us today. So I wanted to see if we could do kind of a "myth and reality check," if you will, on the new tax bill. I know that there are just a lot of questions that people asked and I thought as a Partner and Tax Accountant at RBF, you would be really a great source of maybe knocking down some of these myths that we hear about all the time. So are you game?

Jeff Groff – I'm ready, Kae, whenever you are.

Kae Wagner – Okay. Well let's start with some of the myths about small business. One of the myths is that lowering the tax rate for pass-through businesses creates a massive loophole that wealthy Americans will use to avoid paying their fair share of taxes. Is that true?

Jeff Groff – Under the Tax Cuts and Job Act, there is some provision for pass-through businesses to lower their tax rate. The purpose of that was to bring in line small business owners' tax rate in line with that of the corporate counterparts of larger corporations. So by lowering the tax rate on pass-through entities, what they're actually doing is they're providing a deduction of the pass-through income for the shareholders and partners in those types of entities. Under the new law starting in 2018, shareholders or partners in these pass-through entities can take a deduction of up to 20 percent of their qualified pass-through income.

Kae Wagner – So that's different than what they're doing with the corporate rate and the corporate rate will be lowered to 20 percent and the pass-through rate is lowered to 25 percent?

Jeff Groff – No, that's not correct. Lowering the corporate rate to 20 percent and the pass rate to 25 percent was one of the original proposals. But in order to get the act passed, they needed to negotiate. What wound up getting passed is a flat 21 percent tax rate for C corporations and a 20 percent deduction for pass-through entities. So the 20 percent deduction for the pass-through entities is a reduction in the income that's getting passed through on page one of the individual shareholder or partners' 1040. The 20 percent reduction does not necessarily equate to a specific tax rate because it all depends on what tax rate the individual shareholder or owner is in at that time when calculating all of their income deductions.

Kae Wagner – There's a myth that the new pass-through formula will pick winners and losers by favoring certain industries over others. Do you think that's true?

Jeff Groff – Well there is some truth to that, yes, because the new tax law carved out this deduction for larger service providers such as attorneys, accountants, engineers and people in those types of professions. But if you're on a smaller scale, the new law adds a deduction for non-corporate taxpayers for qualified business income. The deduction is also referred to as a pass-through deduction. It reduces taxable income rather than the adjusted gross income. It's available to taxpayers who take the standard deduction and also itemize. In general, the deduction cannot exceed 20 percent of the taxpayer's taxable income or eligible profit from a pass-through entity. Taxpayers and service-related businesses such as healthcare professionals, law, accounting, actuarial services, performing arts, consulting, financial services, brokerage services including investments and investment management trading, there are definite limitations on how much they can claim with this deduction.

Kae Wagner – So that's kind of a part myth and part reality there. So one of the myths, Jeff, is that this bill is a direct attack on the middle class. What is your response to that?

Jeff Groff – This is another area of the act that does provide some relief for taxpayers all across the board, both lower income, middle income and the higher tax-paying individuals. This is done by reducing rates across the board. All the rates have been reduced a couple percentage points. So everyone, theoretically, will get a benefit from the reduced tax rates. Also by doubling, or nearly doubling, the standard deduction, there are some benefits there for families that did not have enough qualified itemized deductions to take benefit of the mortgage interest, charitable contributions. With the increase in the standard deduction, everyone will have a chance to get more tax deduction before applying their tax rate.

Kae Wagner – Great. So let's look at some of the family-focused provisions. There's a myth, perhaps, that by eliminating the personal exemption, this legislation increases taxes on families. Now how does this Tax Cuts and Jobs Act actually impact families?

Jeff Groff – That is true. They did eliminate the personal exemptions. But in doing so, they also doubled the child tax credit from $1,000 up to $2,000 and they increased the age by one year. So qualifying children, or under the age of 18, would still be eligible for the $2,000 tax credit. By reducing the personal exemption, which is approximately $4,000 per person, the tax deduction on that, dependent on what your tax rate would be. So a family that was in the old 25 percent tax

bracket would receive about a $1,000 tax savings by having a personal exemption. By increasing the child tax credit to $2,000, it basically becomes a wash in that area. Now if you're in a lower tax bracket of only 15 percent, the tax benefit of that would be approximately $600. But now under the new law, you'll get an additional $1,000 tax credit. So there, that would be a benefit to those families.

Kae Wagner – So that's a scenario that all depends, right?

Jeff Groff – Yes. It all depends on the situation. How many exemptions you had in the past and how many you'll have in the future.

Kae Wagner – Right. Let's talk about home ownership. There is a myth or a reality that this bill changes the mortgage interest deduction making it harder for Americans to buy a home and invest in their local communities. Is that true or false?

Jeff Groff – Well it's going to be interesting to see how this one turns out, because it is true, they did reduce the amount of eligible mortgage indebtedness that a taxpayer can deduct the interest from. It used to be a $1 million mortgage debt limitation. They've reduced that to $750,000. So therefore, if you have an individual in a high property area where home values are significantly higher than other parts of the country, there will be a limit to how much mortgage interest they can deduct on their tax return to the reduction in the limitation to $750,000 of qualified mortgage indebtedness.

Kae Wagner – So the American dream of home ownership is not completely dashed?

Jeff Groff – No it's not. And also part of this, they did away with the unlimited deduction for state and local income taxes and real estate taxes. And they put a cap of $10,000 on that. So that's another area where taxpayers in a higher state and local income tax environment, they're going to see a cap on the amount of deductions they can take and that cap for 2018 is $10,000.

Kae Wagner – So let's look at charitable giving. The myth here is that because significantly fewer taxpayers will itemize, that fewer Americans will make charitable donations. Do you think that there will actually be less charitable donations made as a result of this new law?

Jeff Groff – I have read quite a bit about this area. I certainly hope not. I certainly hope that people are making charitable donations for the good of the community or the charities they pick. So hopefully they'll continue to make charitable donations out of the goodness of their heart to help other organizations. Now the reality of it is, by increasing the standard deduction, by almost doubling it for every category, there will be fewer people that see a tax benefit from making charitable contributions. Those who still itemize will still get the benefit. It will carve out a group of people that no longer get a tax benefit by making additional charitable contributions.

Kae Wagner – So some reality in that one. Okay. The death tax has received some coverage, as well. One of the statements about the death tax is that repealing the death tax is just a massive giveaway for the wealthiest Americans. Is that a myth or a reality?

Jeff Groff – That definitely is starting off to be a myth. They did double the exemption for inheritance tax. They did not repeal the death tax yet. So what they've done is they've increased the threshold that it takes for an estate to become taxable. So it's carving out a certain group of individuals who have invested a lot in a small business or possibly a farm, and their estate would not have the cash flow to pay the taxes upon death of the shareholder or the owners. So it did not repeal the death tax yet; it's increased the threshold when it becomes taxable.

Kae Wagner – So this is another example where it's not myth or reality so much as it depends on your situation?

Jeff Groff – That's correct. Under the current exemption amount for estates, there's been very few taxable estates every year. This will reduce it somewhat, but the larger estates will still be affected by it.

Kae Wagner – Now I know when we talked earlier, before we actually started the Podcast, I know that you said there are a lot of interpretations that can be had with this law, which I guess are being worked out even as we speak, and that every person's scenario might be different. And knowing that, what advice would you give to people about their own particular situations?

Jeff Groff – For the majority of people, this is not tax simplification. There will be some individuals that will find it easier to file their tax return: they can claim the standard deduction, file their tax return and they're done for the year. But due to all the different phase-outs and all the different changes regarding how much you can deduct for state and local taxes, the threshold for your mortgage interest limitations, it does become a lot more complex for quite a few people. As we speak, there's still ongoing analysis of all the provisions in the new law. That's why it's important to contact a tax professional to discuss the specifics of your situation.

Kae Wagner – Great. Well thank you for busting the myths and giving us some insight. I'm sure that we're going to be talking about this again as we move through the year, unless things become clearer or maybe not, since it's not necessarily tax simplification as you said. So thanks, Jeff. And hopefully we'll talk to you soon.

Jeff Groff – Thanks, Kae. We'll keep everyone updated.

Kae Wagner – That's it for today folks. Visit rbfco.com for more information on Accounting That Goes Beyond the Numbers. This is your host, Kae Wagner for Ross Buehler Falk. Our next episode is coming soon. Don't miss it.