"The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.

"Politics deals with the same problem by making promises that cannot be kept, or which can be kept only by creating other problems that cannot be acknowledged when the promises are made."

— Thomas Sowell

Tax and Financial Strategies

 Issue # 63 Fall 2018 Part II

Wealth Creation Strategies

The Good, Bad and Ugly in the Tax Cuts and Jobs Act

In the last issue of *Wealth Creation Strategies* (out last week!) we discussed the *very* best parts—those incentivizing entrepreneurial activities, along with somewhat lower tax rates—of the Tax Cuts and Jobs Act (TCJA). In this issue we'll look at the good, the bad and the ugly parts of this new tax law.

The Good and Its Beneficiaries

Roughly four of five taxpayers will see overall tax reductions under the TCJA. Taxpayers with children under age 17 and, as described in issue # 62 of *WCS*, those with net business and/or rental income will, due to the new Qualified Business Income Deduction (QBID), benefit from the largest percentage decreases in tax. When taxpayers have qualifying children under age 17 *and* net business/rental income, expected taxes may plummet by more than 40% in 2018 on the same income as in 2017 for moderate- to upper-middle-income taxpayers, and up to 100% for some low-income ones.

An increased Child Tax Credit with a much higher phase-out level

The maximum Child Tax Credit (CTC) increases from $1,000 to $2,000. (From a strictly economic point of view, this doesn't help grow the economy, but anything that keeps more money in the hands of people and out of the hands of government arguably benefits society.) The old phase-out for the CTC began at $110,000 Adjusted Gross Income (AGI) ($75,000 for non-joint filers). The new phase-out begins at $400,000 ($200,000 for non-joint filers). The credit decreases by $50 for every $1,000 of increase in AGI, creating a 5% hidden marginal add-on tax rate. Most taxpayers with children under age 17 whose income exceeded the old phase-out zone therefore get an instant $2,000 reduction in federal income tax.

The maximum refundable Child Tax Credit increases from $1,000 to $1,400. "Refundable" means that even when the income tax is zero, the government issues a refund for the credit. In this regard, the CTC is similar to the Earned Income Tax Credit, or EITC (the great Milton Friedman's "negative income tax" idea, which wasn't a terrible idea if that was the only form of "welfare"). Claims for both CTCs and EITCs are frequently fraudulent; the General Accounting Office estimates that some 24% of EITCs are "improperly" claimed. To that end, Congress has required that we, as tax pros, exercise "due diligence," which includes reviewing and retaining proof of eligibility for the credit. About a decade ago they turned us into auditors (on a limited scale) by subjecting us to a $507 (inflation-adjusted) penalty for each act of "negligence" in policing eligibility for the EITC; in the last two years we've also been required to police the American Opportunity (education) Credit and the CTC. The TCJA requires us to police Head of Household claims under the same penalty regime beginning with 2018 tax returns.

Those who didn't have enough deductions to itemize under the old rules

Nearly all taxpayers who didn't previously itemize deductions will benefit from the TCJA, not only because tax rates are lower across the board, but also because the increased standard deduction more than compensates for the loss of personal exemptions. Taxes will generally decrease for such taxpayers by 7% (at the very top end of income earners) to more than 20%. For example, a joint filer with $100,000 of ordinary non-Qualified Business Income (see issue # 62 of *WCS* for a discussion of QBI) taking the standard deduction in both 2017 and 2018 will see their income tax plummet from roughly $11,300 to $8,700, a 22% decrease. A couple with $150,000 of ordinary non-QBI will see their tax drop from $23,800 to $19,600, a nearly 18% decrease. A single filer taking the standard deduction with $50,000/$100,000/$150,000 of ordinary non-QBI will see their total federal income tax decrease from $5,600/$18,100/$32,000 to $4,400/$15,400/$27,400, decreases of 21%, 15% and 14% respectively.

Old and New Standard Deductions

Filing Status	Old (2017) Standard Deduction	New (2018-on) Standard Deduction*	Old (2017) "Mature" (65 & up) Standard Deduction	New (2018-on) "Mature" (65 & up) Standard Deduction*
Single or Married Filing Separately	$6,350	$12,000	$7,900	$13,600
Head of Household**	$9,550	$18,000	$11,100	$19,600
Married Filing Joint	$13,000	$24,000	—	—
Married Filing Joint, one over age 64	—	—	$14,250	$25,300
Married Filing Joint, both over age 64	—	—	$15,500	$26,600

* While the increase in the standard deduction seems great, it's mitigated by the fact that the 2017 personal exemption of $4,100 per person was eliminated. I called out the Republicans while the law was being debated for stating a half-truth about the standard deduction nearly doubling, without ever saying, "Oh, by the way, we're eliminating the personal exemption." The new standard deductions aren't much larger than the old standard deduction plus personal exemption, and those with dependents over age 16 end up with less of an overall deduction than under prior tax law (but this is partly mitigated by, as we will see, a new "Family Credit" for such dependents).

** Single taxpayers with one or more qualifying dependents.

Child labor gets a boost

Working dependents (kids under age 19 and full-time students under age 24) can earn up to the amount of the standard deduction without paying any income tax. Because the TCJA increased the standard deduction from $6,350 to $12,000, many more working dependents will avoid paying income tax. Perhaps this is the reason for the elimination of the dependency deduction in favor of a greatly reduced benefit, a new $500 "Family Credit," for each dependent age 17 and older—maybe Congress expects those 17-year-olds to get a job and earn $12,000, income tax free! Increasing the amount that dependents can earn tax free (and at lower rates) is a great idea anyway, since jobs teach skills, work ethics and good habits for life.

Social Security recipients benefit from reduced rates

While there is no change to the complex and draconian phase-in to the taxation of Social Security "benefits," subjecting as much as 85% of this income to income tax (35% of which was already taxed when recipients worked), the implied reduction in the highest "phantom" tax bracket is welcome relief. Above a low income threshold, for every $1,000 of additional non-Social Security income, an additional $850 of Social Security is subjected to tax. Under old law, those in the 15% nominal bracket were in a phantom (but very real) 27.75% marginal tax bracket as 85% of the benefits were added to the taxable base. Social Security recipients, then, paid an extra $275.75 of tax when real income increased by $1,000 (15% of the $1,000 real income plus $850 of additional taxable Social Security).

The TCJA reduces these phantom rates. The new 12% nominal rate plus 85% of 12% = 22.2%, for a [(27.75% - 22.2%) / 27.75% =] 20% reduction in the marginal tax rate over the breadth of that phase-in. Those whose benefits were subject to the phase-in to the taxable base while entering the old 25% bracket were slammed with a (25% plus 85% of 25% =) 46.25% real marginal tax rate. Now, they will suffer a (22% plus 85% of 22% =) 40.7% real marginal tax rate. Still, a nice [(46.25% - 40.7%) / 46.25% =] 12% reduction in marginal tax rate on that "chunk" of income.

For those not itemizing, the increased standard deduction slightly reduces the size of the chunk of income taxed at these exorbitant, phantom rates. Due to the new QBID, Social Security recipients with net business or rental income accrue an even larger benefit; as the QBID reduces taxable income, less Social Security is taxed at the higher marginal rates. In addition, those with net Self-Employment income can deduct their Medicare and related health "insurance" premiums, further decreasing their taxable incomes (this will be a topic of a future *WCS*). Due to a combination of lower tax rates, an increased standard deduction and an $8,000 QBID, one moderate-income ($60,000 range) client's tax is expected to decrease by over 40%. On the other hand, due to the loss of the deduction for personal exemptions, the chunk of income taxed at these phantom rates increases for Social Security recipients who itemized under the old regime and will continue to do so.

Almost every taxpayer previously subjected to the Alternative Minimum Tax gets a tax reduction

In a welcome improvement, the TCJA largely eviscerated the Alternative Minimum Tax (AMT). In 2017, nearly 30% of taxpayers with incomes between $200,000 and $500,000 were hit by the AMT, with nearly every taxpayer in this income zone in high-income tax states and those in low- or no-income tax states but with high property taxes getting hammered by it. Going forward, almost no one in these income ranges will be hit by the AMT. In creating the 2017-2018 comparative "Tax Reform Impact Summary" for each of our clients (you received this if we prepared your 2017 tax return), with only a few very high income (and oddball) exceptions, we didn't see anyone in any income zone who will be hit with an Alternative Minimum Tax for 2018 using 2017 income and deduction figures.

Three major changes have weakened the AMT. One, the exemption amounts (similar to a standard deduction, but much larger) for the AMT were increased by nearly 30%. Two, the points at which the exemption starts to get phased out increased by 621% for joint filers and 414% for all others. Three, the most common deductions in computing the "regular tax" that weren't deductible for the AMT have been either eliminated or dramatically reduced by the TCJA. State and local income and property taxes have been curtailed, and personal exemptions, employee business expenses and deductions for investment expenses (e.g., investment advisory fees) have been eliminated. This makes the near eradication of the AMT almost moot. Under old law, many of our clients were subjected to this hidden tax; without these deductions and without increasing the exemption amounts and phase-out levels, we doubt many would have been hit. Hence, its roll back is largely window dressing. Nearly every deduction for regular tax purposes is still deductible for AMT purposes; even the QBID is deductible for purposes of calculating the AMT. The bad part is this dishonest tax lurks and a future Congress could easily reincarnate it (especially one in which a different majority regains power).

Still, there is at least one, relatively esoteric area in which the AMT rollback is a boon: the tax treatment of Incentive Stock Options. The difference between the fair market value of employer securities and the purchase price an employee pays for such stock is deemed income under AMT rules. If an employee sells in the year exercised, there is no adverse effect; however, where employees hold on to such securities, the results can be devastating. This is especially true if the stock price plummets; we saw several cases after the dot com bubble burst in which, due to the AMT, hundreds of thousands of dollars of tax was owed on gains that evaporated, because the stock price went to zero. The AMT attenuation slightly reduces the likelihood of that egregious inequity reoccurring.

Terminated employees with outstanding 401k loans have more time to repay

Terminated employees previously had only 60 days to repay a 401k loan to avoid paying tax and premature distribution penalties on the loan amount (after 60 days, the loan was deemed a "withdrawal"). Under the TCJA, the employee is now allowed until the extended due date of the return to repay. When taxpayers discover what nonrepayment costs and learn they can later repay and avoid tax and premature distribution penalties, we suspect the currently abysmally low percent (in the teens) who repay such loans will increase substantially. Now, an employee who takes a loan and is later separated from employment as early as January 1, 2018 has until October 15, 2019 (so long as a valid extension is filed) to repay. We will do our part to help increase the number of terminated employees who repay these loans.

TCJA Losers: the Bad

While most taxpayers will see decreases in their personal income tax this year, the tax for roughly one in five increases under the new law. The greatest percentage increases hit those with large state and local income or sales and property taxes and/or miscellaneous itemized deductions (unreimbursed employee business expenses and/or investment expenses), and lack benefits under TCJA other than the lower marginal tax rates.

Married couples who should never have married due to a new marriage penalty

The new law limits the itemized deduction for state and local income (or sales) and property taxes to $10,000, *regardless* of marital status. This is a brand-new marriage penalty. Say you and your significant other live together and share costs on a home. You each pay $6,000 in state income tax via withholding and $4,000 of an $8,000 property tax bill. You each deduct the maximum allowed $10,000 of taxes. If you marry, you're subject to a combined maximum deduction of $10,000. By getting married, you lose the other $10,000 deduction.

With the deduction for state and local income and property taxes limited to $10,000, taxpayers under age 65 will need $14,000 in non-tax deductions to exceed the new $24,000 standard deduction. Single filers paying $10,000 in such taxes need only $2,000 in non-tax deductions to exceed the $12,000 threshold. The odds of itemizing deductions are now much higher for single filers than for married ones.

Those with dependents age 17 and older

The personal exemption would have increased to $4,150 this year, which is worth $492 in tax savings for those in the new 12% bracket, $902 for taxpayers in the new 22% bracket or $984 for those in the new 24% bracket. Deduction exemptions for dependents, which have been part of the law since the inception of the income tax in 1913, have been eliminated in favor of a much larger standard deduction. A "deemed" exemption is still part of the law, which is used to determine eligibility for Head of Household filing status, the Child Tax Credit and a new Family Credit. While taxpayers with dependents under age 17 get an increased Child Tax Credit of up to $2,000, those with qualifying dependents age 17 and older get only the new $500 "Family Credit" for each qualifying dependent. While the $1,000 increase in the maximum Child Tax Credit more than replaces the tax cost of the loss of the exemption for those subject to the new lower tier of brackets (up to 24%), the $500 credit for older dependents is clearly less than the tax-savings value of the old exemption for those in any bracket higher than 12%.

Those with itemized deduction amounts greater than the old standard deduction

Filers whose combined itemized deductions plus personal exemptions were greater under old law than the new standard deduction lose.

Say, last year, a married couple had $20,000 in itemized deductions and two personal exemptions worth $4,000 each (rounding for ease of math), or $28,000 in total deductions. Under the new law, they will deduct a flat $24,000 standard deduction, losing $4,000 in total deductions. It gets worse if they had $24,000 or more in itemized deductions. They had ($24,000 + $8,000 exemptions =) $32,000 in total deductions. They lose ($32,000 - $24,000 =) $8,000 in deductions. The lowered tax brackets are not, by themselves, likely to save the tax lost from the reduced deductions. (Geek note: this may not be true if their income was high enough that they previously lost some of the benefits of deductions due to the Alternative Minimum Tax, in which case the savings from the lower tax rates may exceed the tax cost from losing useless deductions.)

The big losers in this category are joint filers with kids over age 16 and more than about $20,000 of itemized deductions, and who have no offsetting benefits under TCJA other than lower tax rates. For example, the tax increases from $11,000 to $11,800 (a 7% increase) for a married couple with $120,000 in wages, two over-16-year-old kids and $24,000 in itemized deductions.

Joint filers with state income or sales tax plus property tax substantially greater than the new $10,000 limit, and/or with newly unallowed deductions

Those paying state income or sales plus property tax substantially greater than the new limit, or with newly unallowable miscellaneous itemized deductions (employee business or investment expenses), are especially hard hit. In one unusual instance the tax imposed on a joint filer whose state and local income and property taxes substantially exceed the new $10,000 limit increases from $4,000 to $9,000. In another extreme case, the tax on a single filer with formerly deductible large investment expenses increases from $2,000 to $8,000. This could be counted as "ugly" due to the violation of core tax principles, described below under "The Ugly," but is included here, under "The Bad," only because most instances aren't as extreme and are frequently offset by other factors.

Meals and Entertainment Under the TCJA

Type of meal or entertainment expense:	Amount Deductible for 2018-on*		
	100%	50%	0%
Entertainment (golf, baseball, theater, etc.) with clients/ customers/prospects			X
Parties for clients/customers/prospects			X
Business meals with clients/customers/prospects		X	
Employee meals/snacks for the convenience of the employer		X	
Employee meals/snacks required for business meetings		X	
Meals served at Chamber of Commerce or similar meetings		X	
Travel meals while away from home overnight		X	
Parties for employees and their spouses	X		
Entertainment (golf, baseball, theater, etc.) for employees and their spouses	X		
Team-building recreational events for employees	X		
Meals or snacks for the public at marketing presentations	X		
Meals or snacks for the public at open houses (e.g. Realtors®)	X		

* Horrifyingly for purposes of complexity, the rules for California and certain other states for both this and numerous other deductions remain the same as in 2017. You will find the biggest such differences in a chart in the next issue of *WCS*.

Business owners who entertain clients

While half of the cost of business meals are still deductible, the cost of client "entertainment" is no longer deductible. "Entertainment" includes golf, theater, professional sports seats and associated costs (including meals if not separately billed), and all parties for clients/customers. This affects only a few of you. We think this restriction passed because Congress wanted to put an end to deductions for well-publicized $100,000 bashes at night clubs for entertainers and rappers, as well as $100,000 pro-sports box seats for businesses. In the process of going after the big guys, they included the rest of us. Business owners must now separately track expenses for out-of-town meals, in-town business meals, "entertainment and client parties" and, as described immediately below, snacks and meals.

Business owners who provide snacks and meals for employees

Business owners who provide snacks and meals for employees (meals for the convenience of the employer to motivate employees to work overtime and/or through lunches) lose half the deduction for such food items. We think Congress passed this new restriction because they wanted to partially end deductions for fancy Silicon Valley employee lunches. "Snacks and meals" include everything from coffee to employee dinners, whether at the workplace or a restaurant. The only food-related expense that remains 100% deductible oddly consists of employee (and their spouses)-only holiday parties, company picnics and other "employee appreciation events," so party it up—but DO NOT invite your clients!

The Bad — Geeky Stuff

QBID complexity: when total income is too high, SSBs lose. But what is an SSB?

Once taxable income exceeds $315,000 ($157,500 for non-joint filers), the Qualified Business Income Deduction (QBID) is phased out and the calculation can get absurdly complex. For "non-favored" businesses, "**Specified Service Businesses**" (SSBs), the QBID is phased out over the next $100,000 of taxable income ($50,000 for non-joint filers). SSBs are defined as "any trade or business involving the performance of *services* in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners," with engineering and architectural consulting firms intriguingly exempted. SSBs, then, include actors, tax pros and medical services (doctors, veterinarians, chiropractors, etc.). "Financial services" include any trade or business that involves investing, investing management, trading, or dealing in securities, partnership interests, or commodities. Real estate and insurance brokers are also, interestingly, not included among the SSBs.

There are serious definitional issues with this part of the description: "where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners." Fortunately, in newly promulgated regulations, the IRS has narrowly defined such situations to those in which the taxpayer receives endorsement or licensing income for use of the individual's image, voice, name, etc., or receives appearance fees. However, the "performing arts" are not so narrowly defined. SSBs include actors, singers, musicians, other entertainers, directors and "similar professionals." No one yet knows whether this includes editors, producers, writers, make-up artists and others found behind the camera.

The courts will ultimately be involved in the seeming infinite variations. We can't imagine anyone in a non-manufacturing business claiming to be a non-SSB with income in or over the QBID phase-out zone going through life without an audit. It would be nice if the IRS had in place a system in which we could describe a business and get a quick answer from an IRS team that specializes in such determinations as to whether or not they would view the business as an SSB. (Hey, we can dream, can't we?)

QBID calculation complexity: non-Specified Service Businesses (SSBs) with high incomes

"Favored" (non-SSB) businesses can avoid the phase-out if they pay enough wages and/or have enough particular assets. For extreme tax geeks, the deduction for "favored" businesses is limited to the lesser of (1) 20% of taxable income, (2) 20% of net of business income, or (3) the greater of (a) 50% of wages paid, or (b) 25% of wages paid plus 2.5% of the unadjusted basis of depreciable property owned by the business (so long as the property hasn't been owned for too long). (The 2.5% figure was added to ensure most investors with net rental income could benefit from the QBID.) As we said, it's complicated.

A sole proprietor single filer owning a non-SSB with taxable income exceeding $207,500 (or a married one with taxable income exceeding $415,000) paying no wages gets no QBID. The law was designed to encourage non-SSBs to hire employees, which can include oneself if incorporated as an S-Corporation.

QBID calculation complexity: the "unadjusted" basis of rental property owned by high income earners

Rental property owners with total taxable income exceeding the above $157,500/$315,000 figures must overcome another hurdle. The QBID is limited to the lesser of 20% of net business income, 20% of taxable income, or 2.5% of the unadjusted basis (generally, original cost) of depreciable property (plus 25% of wages paid, which is rare in the case of rental property, since most property managers are independent contractors). Depreciable property is included if it's still under its depreciable life of the later of either

(1) ten years after placed in service or (2) its regular ("MACRS") depreciable life (for 15-, 20-, 27.5- and 39-year property). The depreciable period for furnishings and equipment is usually three, five or seven years; such property counts towards this calculation for 10 years, whether or not fully deducted/depreciated via expensing, bonus or regular depreciation. Even 15-year property (such as land improvements) that has been fully deducted in the year of purchase under the new bonus depreciation rules counts for the duration of its depreciable life (true also for rarer 20-year property). Residential rental property counts for 27.5 years; commercial property, for 39 years. If the property was exchanged into, the relevant period is from the date of the initial property's purchase. Anything past these periods doesn't count for these upper-income taxpayers. Note that land, because it is not depreciable, never counts. There are other, even more geeky exceptions and challenges to overcome that few if any readers will understand and, in many cases, no one else understands or can answer. The bookkeeping for this could prove nightmarish for many companies keeping equipment that is no longer listed on the tax return (why list it if the depreciable basis is zero and, under old law, there was no longer a tax benefit?).

Trade-ins of business equipment, including business-use vehicles

Business owners who traded business-use vehicles or other business equipment for similar equipment at a profit could, prior to 2018, trade such vehicles or other equipment and defer the tax on the gain under Internal Revenue Code § 1031 tax-deferred exchange rules. While tax-deferred exchanges for real property held for investment (including land and rental property) are not affected by the TCJA, exchanges of non-real property (business vehicles and other equipment) no longer defer gains. This may be a reason not to do a cost segregation study (the benefits of which are described under "The Best of the Tax Cuts and Jobs Act—All rental property owners…" in issue # 62 of *WCS*), since property determined to have a useful life of less than 27.5 years is no longer eligible for tax-deferred treatment (and property past the minimum 10-year mark won't count towards the unadjusted "basis" for purposes of calculating the QBID as mentioned above).

Faster depreciation for business vehicles (discussed in issue # 62 of *WCS*) will no doubt cause headaches for business owners who unknowingly trade vehicles with low "adjusted basis" (cost minus depreciation previously taken), thinking trade-ins still qualify for tax-deferred treatment. For example, if you purchase a $50,000 100% business-use vehicle, take bonus depreciation in year one and normal depreciation for the next two years, your adjusted basis is ($50,000 - $43,600 depreciation taken =) $6,400. If you trade it in for a new car and the trade-in value of the old car is $30,000, you'll pay tax at ordinary rates on a gain of ($30,000 - $6,400 =) $23,600. Unfortunately, many taxpayers will discover this when it's too late.

Those who trade collectibles or cryptocurrencies at a profit

Only real property held for investment qualifies under the new § 1031 tax-deferred exchange rules. Not only do vehicles and equipment used for business no longer qualify, but neither do sales of anything else, including collectibles (gold/silver, artwork, baseball cards and the like) and cryptocurrencies (Bitcoin and the like). "Exchanges" of stocks, mutual funds and other publicly traded securities have never qualified for § 1031 treatment; non-publicly traded securities haven't qualified since 1924.

The Ugly

There are several very bad aspects to the TCJA, which we call "ugly" because of malincentives, violation of basic tax principles and California's (and a few other states) extreme nonconformity (a comparative chart will be in the next issue of *WCS*).

All unreimbursed employee business expenses: gone

For decades, Congress implicitly agreed with the idea that expenses incurred to produce work-related income should be deductible not just by the self-employed, but also by employees. Long ago many unreimbursed employee business expenses, such as out-of-town travel, business entertainment and business driving, fully offset income; these were in addition to a standard deduction. The Tax Reform Act of 1986 limited the benefit of all unreimbursed employee business expense deductions to itemizers and took an additional 2% of total income (AGI) haircut from those expenses. Later Acts further decreased the value of such deductions for many taxpayers by increasing the scope of the Alternative Minimum Tax (AMT). The TCJA has eliminated all deductions for employee business expenses for federal (and most states—but not California!) purposes.

Expenses incurred by entrepreneurial employees—commissioned sales people, those willing to uproot their lives and travel to temporary job locations, employees willing to keep up with and improve job skills via continuing education and those with multiple employers (such as those in the entertainment industry), who must compete for jobs by keeping tools and supplies up to date—are the sort of people a Republican Congress should have favored. The fact they didn't is in stark contrast to the retention of deductions for nearly all business expenses and the new QBID for the self-employed. What could make sense of this? First, we suspect the IRS lobbied hard to have deductions for employee business expenses eliminated, as they were frequently "improperly" deducted (we've seen many such improper deductions on prior-year tax returns of prospective new clients). Second, we believe this was one of the compromises created by the need to offset tax reductions with tax increases to pass the TCJA via "budget reconciliation," which does not require a supermajority of 60 Senators (which neither party had).

While the loss of these deductions will serve to reduce an entrepreneurial mindset among employees, we believe the elimination of deductions for temporary job location costs is the most egregious new provision. Such deductions encouraged a more efficient allocation of labor resources, especially crucial after natural disasters such as hurricanes, tornadoes, floods and earthquakes. Rebuilding is difficult and expensive enough after such disasters; now, contractors and skilled tradesworkers temporarily moving to affected areas will pass higher after-tax costs to those in greatest need. This will likely reduce the supply of available workers where needed most, exacerbating price increases for their services.

Employees who become self-employed, incorporate or form partnerships can get around these restrictions. While this strategy may prove profitable to the few who can argue around employment rules, it may not be so for many, where extra costs could outweigh the benefits. For example, the costs of incorporating, including additional tax and payroll preparation fees, the employer's share of payroll taxes and, in California, an additional $800 minimum yearly Corporate tax (even on S-Corporations, the net incomes of which otherwise "flow through" and are taxed to shareholders), are among the financial hurdles to overcome.

Differential Treatment of Entrepreneurs and Entrepreneurial Employees 2018-on

Type of business expense	Self-employed entrepreneurs		Entrepreneurial employees (W-2 recipients)*	
	Federal	State	Federal	CA and a few other states
Out-of-town travel to temporary job locations	Deduct	Deduct	Can no longer deduct	Deduct
Business driving	Deduct	Deduct	Can no longer deduct	Deduct
Continuing education	Deduct	Deduct	Can no longer deduct	Deduct
Tools & supplies	Deduct	Deduct	Can no longer deduct	Deduct
Most other "ordinary & necessary" business expenses	Deduct	Deduct	Can no longer deduct	Deduct

* Entrepreneurial employees include outside sales people, truckers, construction workers willing to travel to natural disasters, many if not most entertainment industry employees and others who spend to improve their upward mobility while retaining their current occupation/profession.

All investment expenses: gone

Employee business expenses aren't the only set of deductions cut out entirely: investment expenses, including investment advisory fees, account fees, investment publications, maintenance costs on land held for investment and the like are no longer deductible as federal (and most state) itemized deductions. Previously, we often suggested personally paying investment advisory fees for managing investments held inside traditional IRAs; now, in order to reduce future taxable income, such fees should be paid from the IRA (fees paid from the IRA are not considered income to the IRA owner, and paying them from the IRA reduces the future value of the IRA and, hence, income by the amount of fees paid plus forfeited growth). Because Roth IRAs grow tax-free, fees paid for their management should still (generally) be paid personally. We believe that fees paid for the management of company pension plans including SEPP-IRAs, profit sharing plans, 401k's and defined benefit pension plans are deductible by the company if paid by the company, whether a sole proprietorship (Schedule C), Partnership or Corporation.

The elimination of deductions for investment expenses is a huge loss for a few clients. In one unusual case, investment advisory fees are so large relative to income the tax would triple from $2,000 in 2017 to $6,000 in 2018, except for the fact that much of the income, consisting largely of Roth conversions and capital gains, can be controlled. In other cases, the AMT and 2%-of-AGI limitations already limited or eliminated the value of this deduction, leaving them no worse off under the TCJA. Often, benefits from other changes promulgated by the TCJA will more than offset the increased tax. Still, eliminating the deduction for investment expenses flies in the face of the idea that expenses incurred to produce income should be deductible against that income.

Moving expenses: gone, except for some military

With the exception of military members moving under orders, moving expense deductions and tax-free employer reimbursements have been eliminated under the TCJA. This is very bad, but for reasons having to do not so much with tax savings as with a rational allocation of labor resources.

Government can be useful in facilitating the allocation of capital, including labor resources, by getting out of the way and letting people make their own decisions of where to live and work. Instead, they frequently get in the way. For example, occupational licensing laws, by tampering with the right of contract and freedom to trade, restrict the mobility of those in numerous occupations and professions. Someone licensed as a contractor or hairdresser in one state generally must get relicensed if they move to a new state, reducing the numbers willing to make such moves. Those in rent-controlled apartments are likewise reluctant to move. Those receiving certain "benefits" from government often see a reduction or complete loss of such "benefits" when they move. Because of these and numerous other government interventions, the country has already experienced an enormous reduction in workforce mobility, which reduces the efficient allocation of scarce labor resources and, hence, overall societal wealth. The elimination of the moving expense deduction, which was one of the few proactive provisions government allowed to increase the number of people willing to move for work-related reasons, will further exacerbate the strain on the efficient allocation of labor resources by increasing the after-tax cost of moving.

It can also be argued that the elimination of this deduction violates a basic principle of taxation: that expenses incurred to produce income should be deductible.

Huge business losses: capped

The TCJA caps deductible net business losses at $250,000 ($500,000 for joint filers). This could be tragic from a cash-flow point of view if a joint filer high-income earner earns $2 million in salary (one spouse, perhaps) and/or investment income and loses $2 million operating a business (the other spouse, although they could be one and the same). Under old law, zero tax would be due. Under the TCJA, tax would be due on ($2 million less $500,000 allowable loss =) $1,500,000. The tax on that income, even under the TCJA, is roughly $485,000. The unallowed loss would be carried forward to offset future income, but what if you die first? You lose (in more ways than one). And, both the deducted loss AND the loss carried over would offset future income for purposes of QBI, reducing future QBI deductions. While this situation is rare, it's worth mentioning because when it occurs it will have enormous repercussions for the taxpayer affected. So much for extreme risk-taking entrepreneurs, who could be put out of business before the business becomes a success because the IRS shuts them down for non-payment of taxes; without risk takers, there is less wealth in the form of fewer jobs, goods and services. This limitation is entirely inconsistent with a Party that feigns support of entrepreneurial activities.

Personal casualty losses in other than Presidentially-declared disaster areas: gone

All non-business and non-rental property casualty losses, from fires to Ponzi schemes, are disallowed under the TCJA. This is a very good reason to reconsider your insurance coverage—and, whatever you do, be sure to stay away from any investment schemes that sound too good to be true. We'll have a lot more to say on this in the next issue of *WCS*.

Kiddie tax: simplified, but at the cost of higher rates for some

Dependents under age 24 are still taxed at "normal" rates on work-related income. The "kiddie tax" applies only to non-work (so called "unearned" income, as if you or the parents didn't work hard to earn the investments that created the income, and then didn't squander the savings used to produce that income, but I digress). In previous years the child's "unearned" income exceeding $2,100 was subject to the parent's marginal tax rate. For example, if the parent's marginal rate was 15% and the child had $5,100 in "unearned" income, the kid would owe a 15% tax on the last $3,000 of income, or $450 in tax. Under the TCJA, the parents' tax rate is irrelevant; instead, such income is now taxed at estate and trust rates: 24% on "unearned" income exceeding $2,550, 35% on that exceeding $9,150 and 37% on such income exceeding $12,500, plus a 3.8% Net Investment Income Tax (the abominable new Medicare tax created by the "affordable" care act) on investment income once total income exceeds $12,500. This creates a serious "tax trap" for children or grandchildren who inherit retirement funds or other income-producing assets from parents or grandparents. Grandparents, do not leave taxable (i.e., non-Roth) retirement funds to grandchildren without considering the repercussions of this tax. There is no way around this even if parents die prematurely and children become someone else's dependent.

Do Plusses Outweigh the Minuses, or vice-versa, in the TCJA?

Everyone is affected by the TCJA, many both favorably *and* unfavorably. While some will lose deductions for large employee business expenses and/or investment advisory fees, along with state and local income or sales and property tax deductions, these provided limited if any benefit under prior law for those subjected to the Alternative Minimum Tax; everyone who had such deductions previously lost some of their benefit from the 2% of AGI "haircut" for investment and employee business expenses. In many cases, their elimination is more than offset by lower tax rates, increased (or for higher income earners brand new) Child Tax Credits and the new Qualified Business Income Deduction for those with net rental or business income. It's quite a mix. While it likely won't make the "losers" feel any better, the fact that four out of five taxpayers will see a net benefit is, from the point of view that you can spend and invest your earnings better than any government can or ever will, a net societal positive. Many who don't benefit may be able to rearrange their financial affairs so that they, too, will realize long-term tax reductions.