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JIM: Welcome, this is a must listen to program, because we’re going to be covering the new tax bill. Being that it’s still early in the year, there’s plenty of time to take advantage of things. You don’t want to be bringing your taxes in next year at this time and saying would’ve, could’ve, should’ve, didn’t. We just had all our taxes go on sale, I don’t care who you are, the young, the old, the rich, the poor, everybody is going to benefit from this tax bill as long as you make sure you know how to benefit. Because some folks if they just sit back and do nothing, they might miss some very important features of this bill. Today we have back very special guest, Sandy Botkin, and for those of you that haven’t heard him talk before, he’s a tax attorney, he’s a CPA, he’s an author, he’s written several books, several articles, all focused around saving money on taxes. Welcome Sandy.

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SANDY BOTKIN: Oh, it’s a pleasure to be on.

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JIM: I love having you on when we have good news.

01:00

SANDY BOTKIN: Well most of it is good news. I want to emphasize a couple things here. This tax law was probably one of the biggest changes both in fact from economic perspective and many other ways that I’ve seen in four decades or more. The interesting thing is that most people do benefit. I won’t say everyone, I wouldn’t go as far as you, because for example alimony is disallowed after next year and that’s for those paying alimony they’re going to be real upset, but without question this is one of the most favorable, this could be among the most favorable laws for almost everyone in this country. But the catch, there’s a catch, it’s not automatic, you’re not going to automatically benefit. You’ve got to know the law in order to be able to take advantage of it. That’s the important point here. The second point I want to make before we get into the actual provisions, is to really get to know the law, the one thing you don’t want to do is to treat your accountant like a gym membership. Let me explain what I mean by this. Most people they have New Year’s resolutions. The number resolution is to lose weight, so what do they do, they sign up for all these gym classes. Well, the gym classes, I belong to some of these, and they get very full until about March, then they realize oh, this takes work, not to mention time, and most of those people drop out and now there’s plenty of room in the gym class. Well the same thing is true for accountants. Accounts for three and a half months they’re under a very strict time gun basically, to try and get those tax returns done. The first half of tax season is collecting documents and trying to get new clients. The second half of their tax season is extending returns, doing the returns themselves, and the average accountant has 200 to 300 or 400 tax returns to do on the average. Even if they work 12-hour days they have at most about two hours per tax return to finish the return. Now is that enough time, no, but the point is this system is engineered to possibly make mistakes and to limit how much they can give you, and they certainly are not going to have a lot of time to answer your tax questions on the new tax law, they’re not going to have a lot of time to do continuing education. Most continuing education is done after tax season, usually around June, so if you don’t know what you’re doing, you’re going to lose four to five, maybe even six months of things that you need to know about because your accountant will not have time to deal with this. I do want to make that point very clear.

03:19

JIM: I know today corporations really got some benefit, but so did the personal returns. I think we’ll start out today, let’s talk about the personal returns, and for those of you that are business owners, you do still fill out personal returns, but you’ll want to listen in on some of the corporate strategies that you might want to be considering with your accountant when he gets done with tax season or she gets done with tax season. Sandy, let’s talk about some of the things that people should be aware of as they go forward this year, and maybe a couple of things they might want to think about before they have a chance maybe to sit down with their CPA.

03:55

SANDY BOTKIN: Absolutely. First of all, the standard deduction has almost doubled. We’re talking for single people from $6350 to about $12,000, for married people you’re talking roughly from $12,000 to $24,000. Now you might wonder okay, what does that mean, how does that apply in business. Here’s the reason. In order to itemize deductions, we’re talking about interest and property taxes and minimum state income tax, which I’ll get into what changed there, and other itemized deductions, contributions, it has to exceed your standard deduction. By raising the standard deduction, that means fewer people will itemize, so that’s the first thing that people really need to understand. Yeah, raising the standard deduction is great, but it’s also going to reduce your ability to itemize deductions, so it’s not quite as great as most people are led to believe, but it is good. The second thing you need to know about personal changes is that all state and local taxes, I’m talking state income tax, property taxes, are limited to a total of $10,000 on your home. I’m not talking about property taxes on rental property, they are deductible, or commercial property, but I’m talking about home, principal and second residence, your maximum tax deduction you can get is $10,000. Now if you’re in a state with a high income tax or a high property tax like in New York for example, I’ve seen property taxes of $20,000 and up alone, and I’m not even talking about the income tax, that’s a huge, huge hit, so where’s the tax planning here, why would you want to know about that. Well here’s why. Having a home office deduction now, if you’re eligible, becomes a lot more important than it did before, because if you claim a home office, you can deduct a portion of those property taxes in addition to the $10,000 that you’re allowed. Take an example, let’s say I have a nice big home where I’m paying $60,000 a year in property taxes and I use that home 25% for business, 25% of that $60,000, which is $15,000, becomes a business deduction, and that’s an addition to what you might be able to itemize above that $10,000 limitation. Having a home office is a way of converting some non-deductible property taxes into deductible taxes. Everybody understand that, and that’s one major tax planning tip for you, and so that’s what I said, having a home office is a lot more important than it was before.

06:14

JIM: Talk about the child credit. I know there is a lot of confusion about that.

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SANDY BOTKIN: Okay, well I’ll get into the child credit. It’s not as important for business people, but let’s get into this. To help offset the itemized deductions, congress has increased the child credit. Now that’s a yummy dollar for dollar reduction in your taxes. That’s not a deduction, that’s a reduction in your taxes, and it went from $1000 to $2000 for each qualifying child under age 17, so they’ve got to qualify as your dependent under age 17. In addition to that, you get a $500 credit, which is not as well-know, for certain non-child dependents. Let’s say you’re supporting your parents, people like that. That’s a way of sort of helping you with a child care credit. Unfortunately, what congress gives they take back. The credit starts phasing out, if you’re single it starts phasing out if your adjusted gross earnings is over $200,000, or if you’re married, your earnings are over $400,000. To be honest with you, I mean many of you may say oh well at least I get a $2000 child credit, my personal feeling on this, honestly, is I don’t like it. The reason I don’t like it, I’m sorry they did that, is I don’t see any you know, this whole tax bill, you look at the purpose of this tax bill is, it’s to provide incentives for small business, for them to grow and for them to expand the economy. That’s really the whole focus of this. Giving more money per child doesn’t do that at all, in fact I don’t understand why we would encourage more people, especially if you’re in a lower tax bracket to have more children. That never made sense to me, okay, and it doesn’t seem congruent with this new tax law, but it is available and it’s to help offset some of the loss in itemized deductions, and it’s also a nice political thing because people say well now it’s available for the average person, so there is that child care credit and I did want to mention that, so thank you for bringing that up.

08:01

JIM: Now one other thing, before we switch to the businesses, you know you did mention alimony, and I had forgotten about that. That is the one area where people will not benefit. I know there is kind of like a phase-in where this year you still live under the old rules if I recall correctly.

08:18

SANDY BOTKIN: Yes, the way the rules work is that, if it’s alimony, and we’re not talking child support, we’re talking about support of a spouse, you can deduct your alimony and the spouse gets taxed on the earnings. Frankly, to be honest with you I think they should have left that. The only reason they disallowed it is they figure starting in 2019, so not this year, 2019, that’s one of the very few provisions that start in 2019 by the way, alimony is no longer deductible. They did that because this way the higher earning tax payer will be taxed on that money rather than the lower earning tax payer. It’s sort of a way of raising revenue. I personally think it’s a really bad idea, but that’s really a bit implication if you’re going to get a divorce, because you will not be able to deduct your alimony, so obviously negotiating a lower alimony because it’s no longer deductible is one factor. The second thing you might be able to do, and again this is just something we’re coming up with now, so I’m sure tax practitioners over the next year or two will be coming up with all kinds of planning opportunities under this law, but let me just give you one possible opportunity. Maybe instead of paying alimony you can get the courts to issue an order to the firm that you’re working with to pay a certain amount of your salary or income to your spouse directly, not to you, but to your spouse directly, and then give them a 1099 for that amount of money. So instead of you being taxed on let’s say $150,000, you’re only taxed on let’s say $100,000, and the $50,000 that you would have paid them will go directly to the spouse and be taxed as income. Do I know if that’s going to work, no, but that’s a potential planning opportunity that might work.

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JIM: Now, again, for people that that happens to, so if you get divorced in 2018 or before they won’t be affected by this, it will just be new divorces, right?

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SANDY BOTKIN: That’s correct. It’s only for new divorces that occur after 2018.

10:07

JIM: Alright, then one last thing I’d like to talk about before we shift gears. You know I look at it income tax rates just went on sale, and from what I recall, especially with most earners, I know the top federal rate is still a little bit higher than it had been in the past, but it’s pretty close to bargain basement rates across all bracket, but for the majority of middle class America, aren’t these the lowest rates they’ve seen during their working careers, their parents and their grandparents?

10:34

SANDY BOTKIN: No question. There is no question that these are the lowest rates that I have seen. Now maybe of you may be saying oh, wow what a good deal. I’m going to be saving money in taxes and I’m going to have lower rates, but let me mention one thing that’s not really being mentioned a lot, it’s sort of buried. If I were to say to you, Jim, hey I’m going to give you a $5000 to $20,000, depending on your income, tax cut this year, would you be happy?

10:58

JIM: Absolutely.

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SANDY BOTKIN: Absolutely. And if I said alright, I’m going to do that every year for the next four or five years, would you be ecstatic?

11:04

JIM: Absolutely.

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SANDY BOTKIN: Now, what if I were to tell you, oh, that $20,000 to $100,000 that I saved you, I hate to tell you, but you got to pay it back plus interest at the end of maybe five or six years. How do you feel now?

11:15

JIM: Not as good.

11:16

SANDY BOTKIN: Right. That’s the problem. Where we are financing these tax cuts with a potentially large deficit. I have no problem with tax cuts. I have no problem with a tax system that’s business oriented, in fact I think that’s very smart, but I have a real problem with financing tax cuts, which is sort of like, I’m sure many of you financial planners will know this, it’s sort of like borrowing for a short-term asset, or for an asset that depreciates. It’s a stupid thing to do. The only time you ever want to do that is if you’re in a depression or you need to absolutely turbo charge the economy. But to do that now is an incredibly dumb thing to do, even though there is going to be a lot of happy people, they will not be happy as the deficit rises, which will mean long-term, that’s another thing that we need to plan for, there’s going to be long-term increases in the tax rates. There has to be. If they don’t get the deficit under control, there has to be a long-term increase in taxes,

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SANDY BOTKIN: Now there are two more things I want to cover on the personal side. I want to make sure I get this stated. Basically, casualty losses for any kind of personal property is gone. It used to be if you had a sudden loss from a fire, earthquake, tornado, if you had a loss that wasn’t insured, that wasn’t covered by insurance, you could deduct that loss on your tax return. But now, the only way you can deduct that loss is if you’re in a federally declared disaster area. So if you have a fire and it’s not in a federally declared disaster area, or a tornado happened to hit your house and it didn’t hit hundreds of other houses, you’ve got a real situation, so which means that having the right amount of insurance on everything you own becomes even more critical, and you have to re-evaluate your property coverage on everything you own, the value that’s covered, everything, because you do not want to have an unreimbursed loss these days, you can’t write it off.

14:30

JIM: Well you know we’ve had specialists in auto and homeowners and stuff, and I know a lot of people that are listening today probably have not seen their agents since they signed the paperwork to get the insurance.

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SANDY BOTKIN: Which is the wrong move.

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JIM: Absolutely, so this is just another reason why it’s important to have annual reviews.

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SANDY BOTKIN: That is exactly right. Now another change in the new tax law is a modification of home mortgage interest and home equity interest. First of all, home equity interest is no longer deductible. You used to be able to take out up to $100,000 on a loan on your home and you call it home equity and use that for anything you want. You want to gamble in Las Vegas, you want to go subsidize your kids’ education, no problem, you could deduct the interest on that loan. Now, the only way you can deduct a home equity is if you use the money for business, then it becomes business interest. That’s the only way. Second thing is they limited the interest deduction on primary and secondary residence to a total debt of $750,000. Now what’s interesting is they didn’t limit the interest. If I’m paying 18% on $700,000 that’s okay, but they limited the amount of interest on up to $750,000 of debt, so what the tax planning opportunity there. There’s an old saying in Washington DC where I live, where there’s a will there’s a lawyer. Here’s the tax planning opportunity. Again, having a home office deduction becomes even more critical because let’s take an example. Let’s say I bought a $4 million home in New York, and between New York and California believe me that isn’t that big of home, surprisingly, and I happen to use my house 25% for business, then 25% of that debt is considered business debt, and I can deduct the interest as business interest on 25% of that debt, so I’m getting around a $750,000 mortgage interest limitation, and then in addition I can also deduct the interest on up to $750,000 as an itemized deduction. Again, having a home office deduction becomes very, very critical. The next thing I want to cover, two more things actually.

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JIM: Before you jump ahead Sandy, if go a little long that’s not a problem, we’ve got a lot to cover. You’re talking about a lot of these more expensive homes on the coast, so for those of us that might be in middle America where we don’t have those high expenses, it’s just as important because if you look at it most folks that have let’s say $100,000 left on their mortgage and they’re paying $3000 or $4000 in property taxes, and they might be paying a little bit of state income tax, you add all that up, they still can’t itemize. If you can’t itemize, having a home business allows you to capture those deductions you just lost.

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SANDY BOTKIN: Absolutely, and especially having a home office in particular.

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JIM: Absolutely, so okay, so you have a couple more things on the personal side.

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SANDY BOTKIN: Alright, there’s a couple more things. One the you know, this tax law was passed literally in the middle of the night, like a thief in the night. It was passed very quickly, they did not have a lot of hearings, and basically there is going to be mistakes made, mistakes made by practitioners, mistakes made by all kind of things, inadvertent things that came into play that congress never thought of, and I’m sure you’re going to see legislation to fix some of these inadvertent things. Let me mention just one of the inadvertent things. When you run a business, if that business generates a loss, you can use that loss against any form of income you have. Interest, dividends, wages, your spouse’s earnings, anything. That’s one of the great things about running a business. If the loss exceeds, if you’re self-employed or you’re an LLC and it exceeds your income for the year, you get to carry forward all business losses. This changed by the way, you used to be able to carry it back, but you can no longer do that, that’s one change, but the second change is you get to carry it forward forever and offset against up to 80% of your taxable income forever, so you never lose that loss, it just keeps getting carried over unless you die. Now that’s fine if you have a business. If on the other hand you didn’t run it correctly. You started your endeavor, but you didn’t run it in the way you should, and you’re deemed to be a hobby, the old rules say okay hobby deductions are deductible as a miscellaneous itemized deduction, and then you can take your hobby deductions against hobby income. What does that mean? Let’s say under the old rules I made $5000 on a little side business that I started, and I had $10,000 of deductions, I can only take $5000 of those deductions against my $5000 of income, I wipe out my income, and the other $5000 I lose and that’s the way it is. At least I’m not paying tax, it’s no gain, no foul, I don’t pay any tax. Under the new law, they eliminated miscellaneous itemized deductions, which is where you would claim all the hobby deductions. Unless IRS comes out with some kind of ruling saying what to do about this, what will happen is if you had that same situation where you have $5000 of income and $10,000 of deductions, you’ll pay tax on the $5000 of income and you’ll get no deductions, so running your business correctly, like a business and not like a hobby, becomes much more important. Again, tax planning and meeting with clients, you starting up side businesses is a really important deal here. Okay.

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JIM: What makes it a hobby, Sandy?

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SANDY BOTKIN: Well generally there’s a facts and circumstances test. It’s not generally a specific. I mean if you have a profit three out of five years you’re automatically deemed to be in business. If you don’t have a profit three out of five years, then it’s a lot of factual kind of stuff. I can give you a couple of things. I get a lot more into this in our videos and \_\_\_\_\_ University, but let me give you a couple of examples. Having a good tax tracker is very important, because it’s being organized, that’s what business people do. Having financial statements every year, generating financial statements is very important. Meeting with your accountants to go over those financial statements and to decide where you can cut back so you’re making an attempt to cut back your deductions so to try and turn it around but in a way where it won’t necessarily affect your business is very important. Going to training like this and then to webinars that you provide is very important and documenting that. Meeting with experts is very important. Having good records and receipts helps establish a business. Again, the key is not whether you’re making money. What IRS is looking at, you know I like to say IRS is the biggest bookie in North America, because they subsidize you if you have a loss. But they want to make sure you’re a good bet, so really the key is to run your business like a business with the attempt to try to make a profit whenever possible. That’s basically the bottom line, that’s got to be your thinking. It should not be for social reasons, but it’s to make money.

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JIM: Alright. So, anymore on the personal front, because we’re still trickling into the business front. Is there any more that would be for someone who doesn’t have a business that they should really be aware of.

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SANDY BOTKIN: Yes, a couple other things, or a lot of things actually, we’re not going to have time to do it all. One important thing is medical. Medical expenses have to exceed 10% of your adjusted gross earnings, which is a pretty high number to get one dime of medical deduction. Now that number was reduced under the new tax law to 7.5%, which is still a high number. 7.5% of your adjusted gross is high. If I make $100,000 of income from my business, now let’s assume that’s my adjusted gross earnings, 7.5% of that is $7500 and I’m only going to be able to deduct medical expenses that exceed that. So, the important thing is the way to get around that, which was true under the old law, as well as under the new law, is to set up a health reimbursement account, which we can get into and we will get into say in the webinars and things like this, but a health reimbursement account allows you to reimburse you and your family for medical expenses that are not covered by insurance. Now it does involve usually some hiring of a spouse and things like this, so it’s not medical it’s more of an employee fringe benefit, but you can set up these health reimbursement accounts to reimburse you and your family and completely deduct our medical expenses from dollar one without any threshold, and that is the tax planning tip to get around this 7.5% threshold.

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JIM: Alright, any more on the personal front.

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SANDY BOTKIN: Oh, there’s a lot more on the personal front that we can go into. I mean for example, one of the things if you have sporting tickets let’s say to a college game, you like to go to your nice local college game, but in order to get those ticket you had to make charitable contributions, you used to be able to deduct 80% of those charitable contributions so to speak. I use charitable in quote because you wouldn’t get the ticket unless you made it to get the tickets. Now those things are no longer deductible. You cannot deduct those charitable contributions anymore to get sporting tickets.

23:32

JIM: The moral of the story really is, you really need to sit down with your professionals, your financial professional, your CPA, it would be a good idea if they’re all talking to each other because there are so many different areas that you could trip up, but there’s also so many different areas you could really take advantage, not only on the short term but on the long-term.

23:54

SANDY BOTKIN: There’s no question, and that’s why I said at the very beginning, all these things that I’m going to be talking about are not automatic, you got to know the rules. Now one final personal thing I want to talk about, there are others, but I’m going to get one thing I want to mention, is that under this tax law they have repealed the Obamacare individual mandate. Now what that means, okay I’m telling you what that’s going to mean to you, is that if you decide you don’t want Obamacare insurance, you don’t want to go on the exchange and you want to buy something else, or you don’t want to buy anything for that matter, you will no longer be penalized for doing that. If you want to get different coverage that’s not normally required by Obamacare, you can do that, you are no longer required to do that. Now many of you may say well that sounds good. I don’t have to go on the exchange, I can buy things maybe that’s a little bit cheaper, okay I understand that, but the problem is the thinking of why they eliminated that is that people will drop out will be younger, healthier people who probably that don’t think they need to keep this expensive coverage, so that will mean significantly raising the premiums then they are now

25:06

JIM: Alright, well we’re going to take a short break, and when we return we’re going to talk to the small business owners, which they’ve already gotten a lot of tips already, because on the personal side there’s things you can do by creating a business, but if you’re already in business you’re definitely going to want to listen to the second half, so please stay tuned.

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[BREAK]

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JIM: Welcome back as we continue to visit with Sandy Botkin who is a CPA and tax attorney. As a matter of fact he even trained tax attorneys for the IRS in a prior lifetime. He is the CEO and principal lecturer at the Tax Reduction Institute, and he’s authored the books, *Lower Your Taxes Bigtime* and *Real Estate Tax Secrets of the Rich*. Sandy, are you going to have to with this new tax bill redo those books?

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SANDY BOTKIN: No question I’m going to have to redo it. But surprisingly you know, I would say those books are still 90% to 95% valid in terms of what I’m saying. Most of that is still around. There are going to be some changes, which I’ll get into right now, but most of it’s pretty still tax right on, but yes, I am going to be redoing it.

28:21

JIM: I just got to mention to, Sandy, I know a lot of accountants that are out there. They get done with tax season and they just take a deep breath, and a lot of them go on vacation, and they deserve it, you know, but what we find is a lot of clients don’t initiate those discussions with their accountants, and a lot of times those accountants aren’t counseling, they’re just preparing the returns and getting them done. This is a year you really want to be on top of things. You might want to change the structure of your business to take advantage of some of the brackets that have been created for businesses that are very favorable right now. Go talk to your accountant and have an intelligent conversation where you’re understanding where some of these things might fit in, and now you can discuss whether or not that’s a fit for you, because to rely completely on the accountant, he’s not living your day-to-day stuff, you might be missing out. Would you agree with that assessment?

30:03

SANDY BOTKIN: Oh, I think they are missing out. In fact, we did a study and then we estimated how many self-employed people this applies to, and we figured that self-employed people in business are overpaying their taxes to the tune of billions, that’s with a “B”, and I’m not the only one who noticed this. John Potter, who is formerly head of the American Institute of CPAs said exactly the same thing. I mean people really are overpaying, and the worst part about it is 95% of the people that we’ve surveyed don’t think they are, which is even more shocking. Yea, you’re absolutely right about that.

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JIM: Alright, so let’s go into some of the big things. I know, I mean the tax structure that you create I think is probably the first thing everybody should look at. I don’t know what your opinion is but when I see the difference it’s huge.

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SANDY BOTKIN: Absolutely, the whole choice of entities is a huge deal now. It was always a big deal. You know I think Plato once said the beginning is always the most important part of a work, and I’m sure that’s true in tax structure too. That was always true. But today it’s even more important because certain entities get special benefits, and some of them have limitations that you need to know about, which might force you to be another entity, even though you started off with something else, so it becomes really, really important. Let’s start off. The whole focus behind this entire tax law, the pivotal point was to reduce the corporate tax rates. I mean everything else was essentially incidental to this. That was the main focus. Frankly I think it’s something that should have come a long time ago. They needed to reduce the rates dramatically for many reasons. Corporations, unlike individuals, can simply leave the country, and once they leave the country, which is what’s been happing, they call that corporate inversions, now we no longer get any cash, any revenue on any sales made abroad, nothing. Whereas all we have to do is reduce the rates enough to equal that where the corporations are going to, and then the corporations would stay in this country, we’d receive revenue from all their sales all over the world, and we’d have more job, plus the stock market would go up tremendously by reducing the rates, which is one of the reasons you’re seeing the stock market go up the way it did. If felt it’s something that should have happened a long time ago. In fact, my criticism is they didn’t reduce it low enough, it’s not as low as it should be in order to really prevent corporations from leaving. But they at least made a reasonable attempt. The rates now, the corporate rates used to be a graduated rate up to 35% federal, I’m not talking state yet, okay. Now, you get a flat rate for C-corporations of 21%, which is a phenomenal deal, we’re talking one-third less. In addition, there’s no longer any corporate alternative minimum tax or anything like that. You don’t have to worry about that stuff, so if you’re in a situation where you want to be a regular corporation, and not everybody wants to do that. Being a regular corporation is a huge hassle. You’ve got to have board of director meetings, you’ve got to have stock holder meetings. You’ve got to pay corporate tax, and then if you don’t do it correctly when you pay yourself a dividend you’re taxed on that, which is potential double taxation, so it is a hassle and you got to watch it. But the advantage of a corporation generally is for people and you might wonder why do I want to do it, it’s for people that want to accrue capital. If you want to accrue capital for future marketing or for future purchases of businesses, or for future expansion, and you have to have a good reason, you can accrue capital and it’s only taxed at 21%. Whereas let’s say you’re a partnership, I give you an example, we have this situation where I am, with Tax Spot, where we have several partners. We have to pay tax on the income whether we receive it or not, and we have to pay it at the higher individual tax rates, which makes us have to receive distributions in order to pay those taxes it becomes a problem. Whereas with a corporation if you want to accrue income, you can do it at the corporate of 21%, which is one big reason you want to be a corporation. The second reason you want to be incorporated is if you have a large number of investors, and the third reason would be if you ever want to go public. Every public company that I know of our there is either a corporation or some kind of a real estate investment trust situation. But that’s basically it. Otherwise you probably don’t want to be a regular corporation. If you don’t know whether you’re one you’re probably not one, and most of you probably shouldn’t be a regular corporation. I’m going to move on to the next big change in the tax law.

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JIM: Alright, so Sandy we talked about, and that’s in the area of C-Corps. Now I know in S-Corps there’s always been a lot of discussion because you have the certain amount of wages which should be a prevailing wage, and then the additional income that you get is distributions, which you wouldn’t have to pay the FICA tax on. I know there’s been some changes as far as how those S-Corps work, what is that and how does that work and how should people be addressing that that might have an S-Corp or might be thinking of filing as an S election on their LLC or corporation.

36:17

SANDY BOTKIN: Let me get into the next change in the law, that will deal with part of this. That’s something called pass-through entities. Now we talked about how corporations get a flat rate of 21%. Well congress tried to help out other types of businesses to I won’t say maybe approximate the corporate rate. It doesn’t really come to the same rate because, but the reason it doesn’t is because with corporations, although you do get a much lower rate, there is the possibility of double taxation. Congress didn’t feel they had to absolutely match it, but they did want to come better, do a little better job in approaching the corporate rate. What they did is for a pass-through entity, now what’s a pass-through entity? A pass-through entity is an entity that you’re taxed on the income. You don’t pay a separate tax to the government like a regular corporation, and that includes things like sole proprietorships, independent contractors, LLCs, partnerships, and S-corporations. All those are considered pass-through entities. Okay. If you are a pass-through entity you get a new deduction that was available to you, and this new deduction is essentially, and this is a little complicated, I will tell you. I’m going to tell you what the rule is and then I’ll tell you where it starts getting a little tricky. In case you haven’t heard President Trump say how simple everything is, you can laugh the way I was laughing when he said that. The new deduction is essentially 20% of your net income from your business. What they really call it is qualified business income. Qualified business income is basically your net income from your business not counting investment and earnings, not counting dividends and interest and capital gains and things like that. Okay. You get this is a 20% reduction in your net income. Effectively you are only being taxed on 80% of your income from your business. This applies to each and every business that you have. The media hasn’t made that really clear, but it’s not just one business, it’s each and every business that you have, you get that nice 20% deduction for it. It also applies to rental property that you have a positive cash flow. It can’t create a loss, it only applies if you have a profit, okay. So, that’s pretty straightforward, and it becomes a deduction for taxable income, so it will not reduce your FICA taxes. Let’s take an example, let’s say I make $100,000 in my business, as net income. I only pay tax on $80,000, well first of all remember I pay FICA tax on the full $100,000, but then when I take my deductions I take my standard deduction and then I can also take that 20%or $20,000 pass-through deduction. It’s computed like tax, think of it as an exemption in a sense, so it’s a reduction towards taxable income.

39:13

JIM: You’re only going to save on federal, and I would assume state as well, or state complying with this?

39:19

SANDY BOTKIN: Well right now you only save on federal, but there are some states which automatically piggyback the federal, and for those states that do that, it will work in those states as well. Some states you may be able to do it, and some states you may not, you have to check with the state.

39:36

JIM: Anybody in business with these pass-through entities is really going to want to make sure they sit down with their CPA because this is going to affect their withholdings.

39:46

SANDY BOTKIN: That is correct.

39:47

JIM: Or their quarterly estimates I should say, right?

39:50

SANDY BOTKIN: That is correct. Now, when you think about it that’s pretty darn good, because basically you’re taxed on 80% of your earnings from a business, and if you have a loss you get 100% of that loss against any other earnings and get to carry it over. That’s a heck of a deal, it really is. Okay, which is one big reason why people should be in business these days, and why you’re going to see a lot of people lobbying their employers to switch their status from being an employee to that of an independent contractor. I think you’re going to see a lot of games played that way.

40:24

JIM: How easy would that be to do? Because isn’t there some rules regarding what is an employee versus independent contractor.

40:32

SANDY BOTKIN: Yes, there are, it’s not going to be easy. Basically, you’re going to have to show that that person can work for other firms. They do in fact work for other firms. You’re going to have to treat them like independent contractor with independent contractor agreement, you’ve got to give them a 1099, and even then, it’s tough, especially if you previously treated them as an employee. It is going to be very difficult to do. There’s no question that people are going to try and do it, \_\_\_\_\_ the system. Now so far so good. Effectively you get that 20% deduction from your net income. Now it starts to get a little complicated, alright. Let me explain what’s going on. If you make under $315,000 net, that’s net taxable income, that’s net of all your deductions as a married individual, or under $157,500 net taxable income, you get this 20% deduction without any problem. Okay. I don’t care what business you’re in you get this nice 20% deduction. If you make over $315,000 as a married individual or $157,500 as a single individual net, and let’s say between $157,000 to $207,000 and between $315,000 to $415,000, so it’s $100,000 difference for married and $50,000 for single, then part of that deduction may phase out for certain businesses. If you make over $415,000 as a married individual or over $207,500 as a single individual, then the rules have some limitations. That’s where it gets tricky, so what are the limitations. There are several limitations. The first limitation applies if you’re a certain kind of business, and this is probably where you’re thinking. If you are a specified service business and you make over $415,000 as a married individual of taxable income, so you’ve got to know that before you were to take the deduction, without counting that deduction by the way, or you make over $207,500 of net taxable income without counting that deduction, and you’re a specified service business, you do not get the 20% pass-through deduction, it is gone. What is a specified service business? They were very similar to what was considered specialized service business that didn’t get any special advantage of the corporate tax rates in previous years. Those are things like accounting firms where your reputation and skill is what’s most important. You’re not selling a product, you’re providing a service. Accounting firms would be a specified service business, medical firms, doctors, law firms, actuarial firms, athletes, consultants. This is something very important, but financial services, so financial planners that do a lot of planning is a specified service business and they will not be able to take advantage of the 20% deduction if they make over $415,000 married of net taxable income or over $207,500 single.

44:06

JIM: Now Sandy, is that per entity.

44:09

SANDY BOTKIN: I believe that’s per entity. It’s not clear.

44:12

JIM: Yea, because I just came from a conference where they were talking about splitting the entities and their services.

44:17

SANDY BOTKIN: Aw, now you’re talking about what I was going to say.

44:20

JIM: Okay sorry.

44:21

SANDY BOTKIN: You’re one minute ahead of me. You’re so smart Jim that you think five minutes ahead of me. That’s exactly right. The tax planning that tax practitioners are thinking about. Again, a lot of this is new folks. We’re talking you know literally brand new we’re coming up with this stuff, so we don’t know to what extent it’s really going to work. But one of the things that we’re thinking about is you split your services or what you do into several different entities. You do all your services like financial planning and things like that and investment products that you sell in one company, and maybe insurance sales in another company. The company that deals with insurance sales for example should probably not be subject to the disallowance of that 20%, which means you’ll be able to get that 20%. You split up what you do into several different companies, and if some of those are not specified service companies then you can get the 20% deduction. I do want to emphasize, if you make under $415,000 married, well let’s say under $315,000 because there’s a phase-out between those two, and $157,500 single, you get the full 20% deduction regardless of your business. You only have to start worrying about this if you make over that $415,000 or somewhere in between, but let’s say over $415,000 or over $207,500. That’s the only time you have to worry about it.

45:57

JIM: Let’s move on to something that might affect a lot more people and that is the meals and entertainment.

46:03

SANDY BOTKIN: Before I do that, I want to mention what happens if you’re not a specified service business.

46:06

JIM: Alright, sorry about that.

46:08

SANDY BOTKIN: That’s something that’s very important. Again, folks I didn’t come up with this, congress came out with this. That’s why I said it’s not that simple. Now if you’re not a specified service business then there’s another thing you need to know. The other thing you need to know is this, again, if you’re making under those numbers it’s not a problem, but if you’re making over $415,000 as a married individual, or over $207,500 as a single individual and you’re not a specified service business. You’re selling a product, it could be copiers, or whatever it is you’re doing, okay, but it’s not one of those specified service businesses. And by the way, architects and engineers are not specified service business. By definition congress I guess figures we don’t have enough architects and engineers. Alright. But if you’re not one of those businesses, then although your deduction is not eliminated, there is a potential cap that they put on it. The cap it the greater of either 50% of any wages paid by your entity, or 25% of your wages plus 2.5% of the unadjusted basis of any property you have in that entity. Let me give you an example. Let’s say you’re making as you’re not a specified service business, maybe you’re just selling life insurance and you’re a property and casualty insurance you’re making $500,000 a year and you operate as a sole proprietor or as an LLC. Now normally you would get a 20% deduction on that $500,000, you’d be able to avoid up to $100,000, but since you’re making over the original numbers that I mentioned there’s a limitation, and the limitation is 50% of your wages or 25% of the wages and 2.5% of any depreciable property unadjusted basis. Well, if you’re a sole proprietor you probably don’t have any wages, so 50% of wages is zero, and if you don’t have a lot of property in that sole proprietorship you’re deduction will probably be zero. In that case, you might want to consider switching to a S-corporation or a regular corporation. Now, when you pay yourself a reasonable wage, those count as part of that 50% wage limitation and you’ll be able to take most of that or all of that 20% deduction, so the S-corporations become especially valuable for those people that make over $415,000 as a married individual of taxable income, or over $207,500 as a single individual.

48:42

JIM: That’s clear as can be Sandy.

48:46

SANDY BOTKIN: \_\_\_\_\_ I could do.

48:47

JIM: This is why, I mean what you’re talking about is why people need to get informed. You just wait until next year. I mean we’re not talking a few hundred bucks you might miss, this could get into thousands, even tens of thousands on a personal basis for a business owner if they’re not on top of these changes.

49:06

SANDY BOTKIN: Oh, there’s no question. Let me give you an example. Let’s say on a doctor, I’m going to pick a number, on $2 million but I’m an LLC. I have very little wages, let’s say I pay my nurse, I have one nurse who happens to work with me and I pay her a total of $50,000, let’s $60,000. I would normally take a 20% deduction off $2 million, I would normally take a $400,000 deduction, but my limitation is 50% of wages. Since I’m only paying $60,000 in wages my limitation is $30,000, and that’s all I get as a deduction. But if I’m an S-Corp and I pay myself a reasonable salary, let’s say $500,000, and the other $1.5 million I have as a dividend, now I take that 20% on the $1.5 million and I’m in good shape.

49:50

JIM: Absolutely. It’s significant.

49:52

SANDY BOTKIN: That’s significant. I studied this thing. I got to tell you I spent literally probably 100 hours or more studying this one provision. It really, it’s a complicated provision but it’s well worth understanding, and that’s another reason why it’s so important to go to a good tax planner to really evaluate your entity.

50:11

JIM: Alright, so that’s you know, now we got a lot of small business owners out there that they’re hoping that they might make $1.5 million over their career of their business, so we’ve got some other deductions that might affect them. Probably one of the most biggest most common ones that people are aware of is the meals and entertainment and there’s been some changes there.

50:32

SANDY BOTKIN: Yes, there has. Alright, you know in prior years when we talked about meals and entertainment it was like one word. It was always treated the same. Basically, you were able to deduct prior to 1984 I think 100% of your meals deduction for business, that you incurred in your business, 10% of entertainment, that was changed under the Reagan law to 50%, so you could deduct 50% of your meals and 50% for entertainment. Well, the new tax law deals with this, and they didn’t deal with it well to be honest with you. In my opinion this is one of the poorer things they did in the tax law. First thing they did was they eliminated all deductions for entertainment. It used to be you could write off things like taking a client for example to a basketball game. That’s not deductible. Plays, season tickets are no longer deductible. Those big box seats that a lot of these law firms have on the NBA games and NFL games are no longer deductible. It will be interesting to see what they do with those box seats these days. All entertainment is gone. No exception in that regard for entertainment. That’s when you have a prospect. Now meals is a different animal. They’ve actually separated the treatment between meals and entertainment, which is something that was never done before. Not only did they separate it, but there are different types of meals. Generally, meals with employees are deductible. If you provide free meals like free snack, cokes, things like this you can get a 50% deduction. If you have an employee outing I think it’s 100%. If you have a year-end party you get 100% if they’re you’re employees and members of their family. That’s fine for employees. You have a seminar and you’re providing food as part for your employees. If you do seminars where you sell, where you get a price, which is what I do, I do seminars and I sell people to come to my seminar, you can deduct 100% of the cost of the food because you’re charging them essentially for the food as well. Where there is a confusion is what happens when you have a nice quiet business meal with a client at a restaurant. That is the question. I will tell you that unfortunately the new tax law doesn’t make it clear. All the tax professionals I’ve talked to are split, and if you do research on the web you will see there is a split of opinion on this because it’s not clear. The majority thinking of the people who I’ve read, and I’ve read every article written on it and I’ve spoken to dozens of CPAs, is that the meal deduction for when you have a meal with a client is still around and you can still deduct 50% of it. It is my recommendation to you, and for those of you who are advising clients, it is my recommendation that you do take the meal deduction and you tell your clients absolutely to document it, so you have to document six things, who, what, when, where, why and how much in a good tax tracker. The reason I’m say this is for several reasons. One, it could be deductible. As I said it’s very confusing. It’s not clear. I can give you a good argument both ways in fact. The second reason you want to take it is if IRS comes out, and we do need an IRS ruling on this at some point, they will come out, but if IRS comes out and says it’s not deductible, because there’s a tremendous amount of confusion in the industry, there’s a good chance that IRS will have a grace period like they did with some of the things in Obamacare. If you document it correctly, you may be able to get the deduction anyway. The third reason you want to take it, if it’s not within the intent of congress, congress can change the law, which they will do some fixes and make it deductible, but it won’t be so if you don’t have the right documentation. The final reason that I recommend documenting meals with clients, is that even if the IRS comes out and say oh you can’t do it anymore, it’s still good to have tracking of your expenses, especially to provide that you’re a business, not a hobby, to show you’re documenting things you’re incurring for that business, whether it’s deductible or not. To me tracking expenses are very, very important. For a number of reasons, even though it’s unclear, I recommend you take the deduction, you document it, and if you’re giving advice to clients I would give them the same advice.

54:52

JIM: Alright, one other thing is what about changes in automobile expenses.

54:58

SANDY BOTKIN: Alright, automobile is actually one of the biggest changes for small businesses. For whatever reason, congress in the past 20, 30 years tried to disallow the deductions for luxury cars. For some reason they didn’t want people to buy BMWs and Cadillac’s and expensive cars in their business and write it off, and they put all kinds of limitations. As a result of the new tax law, there’s been a major improvement in automobile, and they have literally in many cases tripled the yearly depreciation caps that used to be available. Now, let’s give you an example, let’s I say I buy a $50,000 BMW and I use it 100% for business. I know 100% is a little bit of an exaggeration. The changes of you doing that are pretty slim, but I’m doing this just to make my math easy. You used to be able to write it off under the old law it would take you about 18 years to write off that BMW. Hey, they said BMWs would last longer, I guess we’ll find out. But under the new law, it takes about 5.3 years. We’re talking about a substantially improved depreciation on automobiles, and I promise you you’re going to see ads on the paper saying buy a Mercedes, buy a BMW, buy a Cadillac and eliminate your taxes. Of course, you will also eliminate your cash, but the point is you will see that and that’s one of the reasons you’ll see that, so that’s one huge improvement.

56:23

JIM: So how does that work for people that might already have a car. Are they still under the old rules or do they just start adopting the new rules and depreciate quicker.

56:30

SANDY BOTKIN: You know, I’m not sure of that, I’ll have to look. Somebody asked me that and I forgot to research it. I don’t know the answer to that. I think they’re limited. I think starting in year two they come under the new rules, but I just don’t know, I’m going to have to look.

56:43

JIM: Now I know, I’ve heard it said that this tax law change is as big as the one that Reagan had in 1986 and there was another one in 1953 or 1954, and they look at these as the most significant changes in the tax law. So we’ve got a lot to cover. We went long here and there is one more that I’d like to cover a little bit more in depth. We talked about it before the break and that’s HRAs. I see this as being a huge thing, and I think other benefit programs too. When we talk about money purchase or defined benefit plans might come back and be more popular. As you talked about phase outs for the higher earners, there might be some ways to get the income to match up properly so that you’re not paying too much in tax. Talk about that HRA again. I mean I remember you bringing this up about a year or two ago. I think under the new tax law with itemized deductions almost doubling and the limits and caps on what you can deduct for mortgage interest and all these things, something like an HRA for a small business owner I think is going to be probably one of the biggest things they can save money on.

57:56

SANDY BOTKIN: There’s no question, you’re absolutely right about that Jim. I mean right now, I mean to me it’s incredibly stupid when a business owner has all these medical expenses and most of them aren’t doing it right. Most of them are saying to themselves, oh, my deductions have to exceed 7.5% of my adjusted gross earnings, so since they don’t I can’t take any medical deduction. They’re not being smart about it. The savvy business owners that I know are hiring their spouses in their business, and you can do this if you’re a sole proprietor or an LLC, and setting up these things called HRAs, Health Reimbursement Accounts, where you’re reimbursing your spouse, who is your employee now, could be part-time, but your employee, and members of their family, which means you and the kids, for medical expenses that are not covered by insurance. I mean I’ve done this in my company a number of years ago where I was, then I was a regular corporation, so you can do it then without even having to hire someone, but I was able to write off over $10,000 in braces that way. Now the key with an HRA though is you want to use a good fiduciary. There are companies out there that will, they’re not expensive either, we’re talking, what are we talking about $40 a month or something like this, but they’ll do the whole plan for you so you don’t need to go to a lawyer. They’ll give you a debit card, they’ll do the accounting for you, they’ll do all of that stuff and it will generate tens of thousands of dollars. My partner figures, he set up an HRA several years ago, I told him about it, and he figures that he saved at least $24,000, imagine $24,000 over the last four years. To me to not do that is really stupid. It’s something that you should really look into, it’s called an HRA. If you’re single you might be able to still do it. You can do it by incorporating, you can do it in another way by setting up a health savings account, which is not an HRA but it’s a little different. After you put money away into a bank account and get a deduction that way. But there are ways whether you’re single or married to take advantage of avoiding the 7.5% limitation, that’s the key.

1:01:56

JIM: Well Sandy, I really got to thank you. Normally we time these things at about 20 to 30 minutes, but this was a monumental tax change, and I appreciate all that you shared, and I know we probably hit the tip of the iceberg, but I really would encourage people, especially go in to some of the stuff that Sandy’s prepared to arm yourself with some knowledge so that you can have intelligent conversations with the professionals that you’re working with, and make sure you don’t delay. This tax law is temporary, it ends in eight years, right?

1:02:31

SANDY BOTKIN: Supposedly it ends in 2025, end of 2025.

1:02:36

JIM: We might have a change before then, but this, unlike the last tax bill that’s passed, is no permanent. It is definitely temporary.

1:02:46

SANDY BOTKIN: That’s correct. Actually, some things are permanent. There are a few things like the corporate tax rates that they left that are permanent, but many things are not.

1:02:54

JIM: As we learned with tax code, even permanent is not permanent, right?

1:02:58

SANDY BOTKIN: That’s true.

1:03:00

JIM: Taxes are on sale and these are the lowest rates. I always share the story of a Honeymooners episode where Ralph is fretting about getting a letter from the IRS and he apparently forgot to sign it and Ralph Krandum (SP?) and Norton is like well did you tell them about the money you won in bowling, did you tell them about the money you found on the street. They want to know about all that income that you have. He thought he was in trouble with all that. But that prompted me to go look at the old tax rates, and back then in the 1950s the smallest rate, where taxes started at, was 20%, and the top federal rate was 91%, and that wasn’t the highest rates. We had 70% in the 1970s, and we look at this and we have most Americans that are tax payers fall into the what used to be the 15% bracket is now only 12%, so it is really time for people as they’re getting into their home stretch for retirement, or maybe they’re in retirement, if you’ve got accounts that you haven’t paid taxes on yet, you might want to look at accelerating that and taking advantage of the sale that’s running right now with the IRS. Thanks again, Sandy.

1:04:17

SANDY BOTKIN: It’s my pleasure.

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