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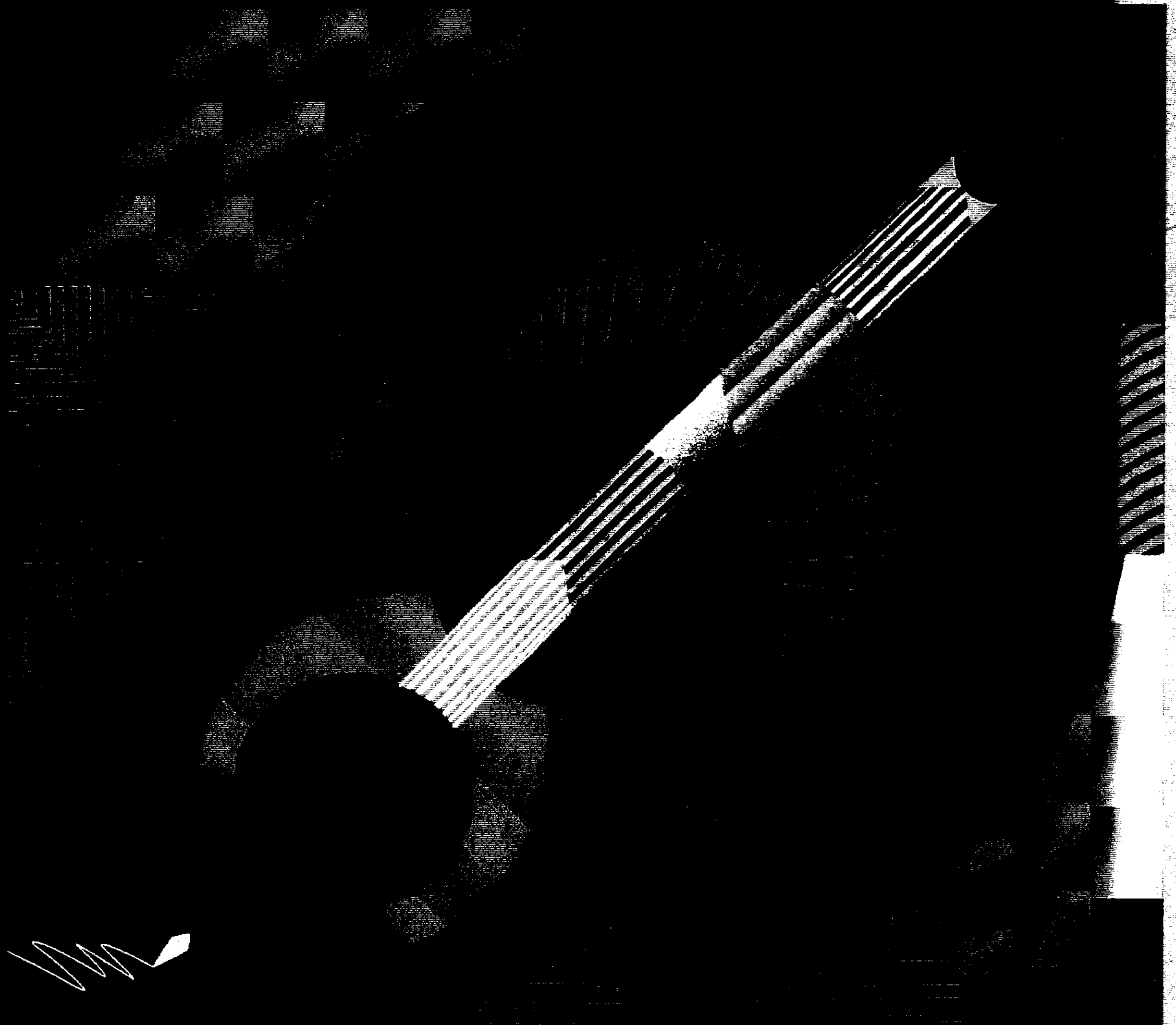

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AN AUTHOR'S GUIDE TO THE REVISED TAX CODE

Cuts, deductions, write offs and rates

By Cheryl L. Davis
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The many changes to the federal tax law passed by Congress last fall took effect on January 1, 2018. These changes will apply to your 2018 earnings; they do not affect your taxes payable for 2017. While the IRS is still working on implementing rules to provide guidance on how to interpret certain provisions, this is what we know so far.

Self-employed authors may continue to deduct business expenses, so for many authors, it will probably continue to make sense to itemize deductions. If you decide not to itemize (because your total allowable deductions under the new law add up to less than the new standard deduction), you may benefit from the slightly higher effective standard deduction and slightly lower tax rate, at least until 2025, when the new lower rates expire. If you do itemize, and you live in a state with high property and real estate taxes, you may actually see your taxes go up. If your total state and local taxes are less than $10,000, your taxes may be slightly lower until 2025. The IRS has not yet provided any direction as to whether authors might be eligible for the deductions for pass-through entities (details below), and so we cannot yet advise on whether it would make sense from a tax perspective for an author to set up a pass-through entity.

Tax Rates

A major change in the tax law is the reduction in tax rates. The largest reduction is at the corporate level; the tax rate for corporations has been cut from a maximum rate of 35 percent to 21 percent.

Individual tax rates will go down slightly for most people, with the greatest cuts being felt at the top tier, and minor reductions being made for other brackets. The top tax rate (which applies to single individuals with earned income over $500,000 and married couples filing jointly with earned income over $600,000) has been reduced from 39.6 percent to 37 percent. These cuts, along with many others, will expire after 2025; the corporate tax cuts are permanent.

Standard Deductions and Personal Exemptions

The standard deduction is being raised for most taxpayers, but few will see much of a real benefit since the personal exemptions have been completely eliminated, as have many other itemized deductions. As a result, the effect of the increase in the standard deduction is actually quite slight. For those filing as single individuals, the standard deduction will be increased from $6,350 ($10,400 if you include the now-eliminated personal exemption) to $12,000. It will be raised to $24,000 for married couples filing jointly, up from $12,700 ($20,700 if you consider the personal exemptions). For those filing as married couples with two children, however, the new standard deduction will amount to a decrease, even with the child tax credit increasing from $1,000 to $2,000—if you count the loss in personal exemptions from $28,700 (the previous standard deduction plus exemptions amount for married couples with two children). All bets are off in 2025, however, when these deductions and exemptions revert back to their prior levels.

One change that will increase taxes for homeowners in high tax states is that all but $10,000 of state and local tax (including property tax) deductions (commonly referred to as "SALT") will no longer be deductible. Residents of states with high taxes, such as New York, New Jersey, and California, will feel the squeeze, and their taxes will likely increase. This is somewhat ironic, since state, local, and property taxes have been deductible since the inception of the federal tax law (to prevent "double taxation").

Taxpayers will still be able to deduct the interest on mortgage debt up to $750,000 for their primary home and one other "qualified residence." Homeowners in areas with high property values, such as the New York metropolitan area, as well as many counties in California and some Philadelphia suburbs—all generally areas with high local taxes—will feel the rub here, too, as the mortgages of many properties in these locales exceed the limit.

As such, the overall impact for homeowners in these areas will be a significant tax increase. It is also predicted that home values are likely to decrease in the short run as a result of the reduction in SALT deductions.

Medical Expenses

Under previous tax law, taxpayers could deduct out-of-pocket medical expenses that exceeded 10 percent of their adjusted gross income. This deduction was adjusted to make expenses that exceed 7.5 percent of adjusted gross income deductible—until 2019, when the figure will go back to 10 percent.

As we have previously noted in our blog posts on this topic, the individual mandate of the Affordable Care Act (ACA)—the requirement that individuals must buy a qualifying health insurance plan or pay a penalty—has been effectively eliminated, with the penalty being reduced to zero in 2019. It is clear that this was intentional on the part of the current administration, as part of its ongoing efforts to repeal the ACA. This is expected to lead to higher health insurance premiums for those who don't qualify for premium subsidies (because the point of the individual mandate was to widen the risk pool and lower premiums for all); it has been predicted that the change will lead to 13 million fewer people having health insurance in 10 years.

Pass-Through Businesses

Starting in 2019, certain individuals will be able to deduct 20 percent of their qualified business income from a partnership, S corporation,[1] and sole proprietorship. (These types of entities are not subject to income tax, because the entity's income "passes through" to the employee-owners, who are then taxed as individuals.) Under the new law, 20 percent of the income that such an entity

1 According to the IRS, "S corporations are corporations that elect to pass corporate income, losses, deductions, and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income" (www.irs.gov/businesses/small-businesses-self-employed/s-corporations).

FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE CONFERENCE AGREEMENT

IF TAXABLE INCOME IS:	THEN INCOME TAX EQUALS:
Single Individuals	
Not over $9,525	10% of taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$45,689.50 plus 35% of the excess over $200,000
Over $500,000	$150,689.50 plus 37% of the excess over $500,000
Heads of Households	
Not over $13,600	10% of taxable income
Over $13,600 but not over $51,800	$1,360 plus 12% of the excess over $13,600
Over $51,800 but not over $82,500	$5,944 plus 22% of the excess over $51,800
Over $82,500 but not over $157,500	$12,698 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$30,698 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$44,298 plus 35% of the excess over $200,000
Over $500,000	$149,298 plus 37% of the excess over $500,000
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000	$8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000	$28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600,000
Married Individuals Filing Separate Returns	
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $300,000	$45,689.50 plus 35% of the excess over $200,000
Over $300,000	$80,689.50 plus 37% of the excess over $300,000
Estates and Trusts	
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

passes through could be deducted, substantially reducing the income on which the owners would ultimately be taxed. This could be of real benefit to sole proprietorships.

Authors and other creators were eager to find out whether they can benefit from this change in the law by establishing a pass-through entity such as an S corporation, partnership, or sole proprietorship. The hitch is that the law limits the types of pass-through entities that are eligible to take this 20 percent deduction, and as stated in Section 1202(e)(3)(A) of the Internal Revenue Code, expressly carves out "any trade or business where the principal asset of such trade or business is the reputation or skill of one or more employees [i.e., owners]." This restriction is meant to prevent employees from becoming contractors and using pass-throughs to take advantage of the tax break.

We have been advised by Robert M. Pesce, CPA, of Marcum LLP that the IRS has finally made it clear that self-employed writers are permitted to deduct 20 percent of their annual net income from writing provided the total taxable income is not more than $315,000 (if married) or $157,500 (if single); this applies to a writer acting through a pass-through entity or as a sole proprietor. However, for writers with taxable income in excess of these amounts, their ability to deduct the 20 percent is still uncertain.

THE IRS HAS FINALLY MADE IT CLEAR THAT SELF-EMPLOYED WRITERS ARE PERMITTED TO DEDUCT 20 PERCENT OF THEIR ANNUAL NET INCOME FROM WRITING PROVIDED THE TOTAL TAXABLE INCOME IS NOT MORE THAN $315,000 (IF MARRIED) OR $157,500 (IF SINGLE).

Business Expenses

Authors who work as independent contractors should still be able to deduct business expenses, including home office expenses and commissions paid to agents. If an author is treated as an employee for any particular project (for which you receive a W-2 instead of a 1099), however, the commission and other business expenses will no longer be deductible.

Higher Education

Student loan interest is still deductible, and graduate student tuition waivers are still alive and kicking (meaning that graduate students need not consider the reduction in their tuition as taxable income). Teachers can continue to take a limited deduction for certain job-related and classroom expenses.

Alimony

Alimony and separation payments are not deductible for divorce or separation documents signed after December 31, 2017.

According to a CNBC poll, conducted between March 17 and 20, 2018, only "32 percent of the public reports having more take home pay because of the tax cuts, including only 48 percent of Trump supporters and 35 percent of the middle class. More than half say they see no change in their paychecks and 16 percent are unsure. It could be that more time is needed for people to notice the change. It could also be that the tax cut provided too small a break to be meaningful to many Americans." AG