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Happy New Year! Let's just jump right to the loud, stomping elephant in the room, shall we?

A Not-So-Brief Summary of the Tax Cut and Jobs Act of 2017

It's hard to tell if our holiday present from Congress is what we really wanted from Santa since the 1,079-page manual (yes, really!) seems like it's written in gibberish. Here's my best effort at breaking down what's included. If nothing else, there is one overarching concept - any changes to corporate tax provisions are considered permanent while those relating to individual taxation will sunset in 2026, reverting to 2017 levels. All this with the understanding that any of it can change again before 2026 with another tax act.

Let's start with the easier parts of the new act - the corporate business provisions. As widely touted, C-corporation taxes are cut from 25% - 35% to 21% (down as much as 40%). Less advertised is that if the C-corp has income under $50k, its previous 15% rate now rises to 21% (up 40%). The big push in selling the tax law was to incentivize large corporations to repatriate monies retained abroad. The deemed repatriation provision taxes all previously-untaxed earnings and profits at 15.5% for cash and 8% for earnings and profits reinvested back into the corporation's foreign subsidiary's business. It's really hard for me to dispassionate about this. Big Corporation, Inc. gets a 40% tax cut and still gets to use its money abroad at a tax rate of 8-15.5% but Small Mom and Pop Shop, Inc. on the corner actually gets a tax increase of 40%.

As we climb down the corporate complexity ladder, so to speak, what's in the new act for "smaller" businesses and consultants that are organized as sole proprietorships, S-corps, LLCs and partnerships? This part is convoluted and I admit to not fully grasping the fringe details of this one but... Any corporate structure that functions as a pass-through entity gets to exclude 20% of the profit from taxes. However, if the business is a "specified service business" defined as any trade or business where the principal asset is the reputation or skill of one or more of its employees or owners (think lawyers, accountants, financial planners, doctors, professional musicians and athletes), there are a series of calculations meant to phase out the exemption based on total *household* taxable income. So, if you own one of these pass-through entities and your total household taxable income (not just income from the business endeavor) is less than $157,500 (single)/$315,000 (MFJ), you get the 20% exclusion. If total taxable income is more than that, we'll have to brush up on our higher algebra. The specified service business specifically exempts engineering and architectural firms from the phase out. And, oddly enough, rental properties filing Schedule E can utilize this 20% exclusion. The phase out was meant to disallow businesses like hedge funds from taking this exclusion. But, with the $315,000 income phase out, it would be easy for a couple, one of whom is an employee earning a $200,000 salary and the other having a small consulting business with net income of $125,000, to get caught up in this loop. Reasonable intention, lackluster execution?

Now onto the individual taxpayer provisions. Grab some coffee and remember, I'm just the messenger.

First, let's review how our good ole 1040 for 2017 works. The calculation can be simplified as follows:

Total Income (Wages, interest, pensions, capital gains, SSI, etc.)	$ xxx,xxx
Minus: Deductions for Adjusted Gross	- xx,xxx
Equals Adjusted Gross Income (AGI - bottom of page 1)	$ xxx,xxx
Minus: Greater of Standard or Itemized Deduction (Sch A)	- xx,xxx
Minus: Personal & Dependency Exemptions ($4,050/person)	- xx,xxx
Equals Taxable Income	$ xxx,xxx
Multiple by Applicable Tax Rates	* xx%
Equals Gross Tax	$ xx,xxx
Minus Tax Credits &Withholdings from paycheck	- x,xxx
Tax Due / Refund	***$ xx,xxx***

Moving expenses, IRA contributions, self-employment deductions, etc.

Medical expenses, mortgage interest, charitable, state and local taxes, misc. itemized deductions

If we work our way from the top down, income remains essentially the same. This is the area where the 20% exemption on the pass-through entity income would decrease income.

In the deductions for gross income, the write-off for moving expenses has been eliminated.

The big uproar has been the substantial revisions to our beloved Schedule A - Itemized Deductions. In general, at the top page 2 of the 1040, the taxpayer deducts the greater of the standard deduction or the aggregate of all itemized deductions. If you live in a state with high income tax and/or real estate tax, it's not hard to exceed the 2017 standard deduction of $6,350 (single)/$12,700 (MFJ). Now, the standard deduction is almost doubled to $12,000 (single)/$24,000 (MFJ) while caps/eliminations are placed on many itemized deductions, which may make the whole idea of itemized deductions moot for most taxpayers.

Let's go through the Schedule A - Itemized Deductions section by section to see all the revisions. First up is the deduction for Medical Expenses. This tax act is actually just the undoing of a previous change. For 2017 and 2018, the amount of medical expenses that can be itemized reverts back to any amount over 7.5% of AGI, down from 10%. In 2019, the threshold goes back up to 10% of AGI. Great news for 2017 taxes if you had extensive medical expenses, but remember, for 2018, this amount plus any other itemized deductions have to exceed the new, higher standard deduction.

Next is the deduction for local and state taxes - which includes the greater of state income taxes or general sales taxes, real estate taxes, and personal property taxes. This is the change that many people living on both coasts of the country are really upset about. This deduction, which was previously unlimited, is now capped at $10,000. For middle-income wage-earning homeowners in places like CA and NY, these expenses alone would easily exceed even the new, higher standard deduction. But the cap means needing another $14,000 in *other* itemized deductions, essentially eliminating a huge write-off for these taxpayers.

But wait - they still get the mortgage interest deduction, right? Yes… but... if you purchased your home in 2017 or earlier, your first mortgage interest is allowable in your itemized deduction for loans up to $1 million. If you purchase your home in 2018 or later, you can only itemize the interest on $750,000 of the loan. And you still need to end up with total itemized deductions over the new standard deduction. Also, the deduction for interest on home equity loans is eliminated no matter when it was put in place.

Charitable contributions are still eligible to itemize but again, your total itemized deductions will need to exceed the new standard deduction. Miscellaneous itemized deductions have been completely decimated. This means no deduction for tax preparation fees, unreimbursed employee expenses or investment management fees. The bottom line here - it's going to be awfully hard to itemize deductions anymore.

If we head back to the 1040, we find the elimination of the personal exemption, which provided a deduction of $4,050 for each person on the tax return. So, in essence, for a married filing joint return who is no longer able to itemize, the standard deduction went up $12,000 but they lost $8,100 of personal exemptions, meaning a net reduction in taxable income (not tax due) of only $3,900.

The most substantial change getting the least attention is the revision of the actual applicable tax rates themselves.

Old Rate	10%	15%	25%	28%	33%	35%	39.6%
New Rate	10%	12%	22%	24%	32%	35%	37%

That looks promising but the dollars amounts that specify the bracket have changed as well. The 10% income bracket remains the same. If you were paying 15%, the marginal rate has decreased to 12%. Most of the 25% bracket gets the 22% rate while the higher end of the 25% bracket sees only a 1% cut to 24%. The lower portion of the 28% bracket gets reduced to 24% but the higher end of the single filers have an increase to 32%. The 33% bracket single payers get an increase to 35% while MFJ drops to the 24%-32% , the 35% bracket stays the same and the 39.6% gets a decrease to 35-37%. In the middle, the higher middle class gets a tax increase while those making $600,000 or more get a tax cut. Yes, it gives me a headache as well.

If there are dependent children under age 17, the child tax credit doubled to $2,000 per child. If the taxpayer is in the 25% tax bracket, the $1,000 additional tax credit is essentially equivalent to the $4,050 personal exemption lost. There is a new non-refundable $500 credit for qualifying dependents other than qualifying children. This would apply if, for example, you are supporting and claiming aging parents or children over age 17.

Outside of the everyday tax filing, there are a couple of additional changes about which we should know.

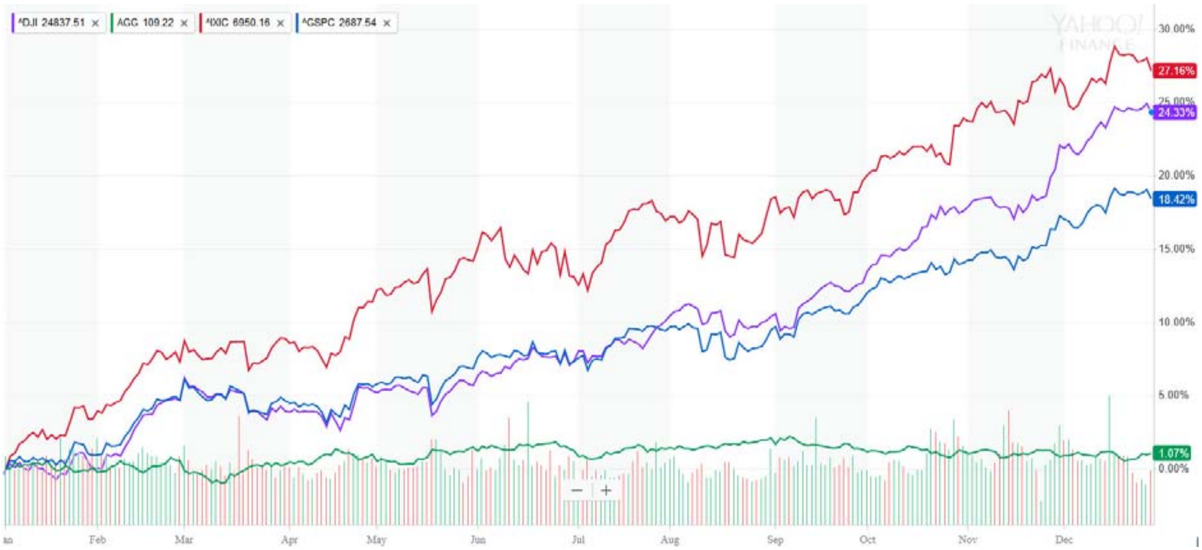
- The exemption for the Alternative Minimum Tax (AMT) has increased to $70,300 (single)/$109,400 (MFJ).
- Investors can no longer recharacterize a Roth conversion.
- 529 Plan accounts can now take a withdrawal up to $10,000 per year per child to be used for K-12 expenses. I have not seen much detail on this but I presume it has to be expenses paid to a qualified educational institution much like the requirement for college expense. So, it's likely we won't be buying junior a car with 529 plan monies yet. By the way, for those with Coverdell Education IRAs or young children, the idea of eliminating these accounts or at least disallowing further contributions was on the table in early provisions of the bill. If you have not yet established a Coverdell for your minor child or have not been making the $2,000 annual contribution, you might consider doing so while you still can.
- The estate tax exemption doubles to $11.2 million per person. If a taxpayer passes more than that on to heirs, the 40% tax rate is unchanged.

Last but not least, starting in 2019, the individual mandate portion of the Affordable Care Act is repealed. Starting then, taxpayers will no longer be penalized for being medically uninsured. However, the healthcare marketplace with its subsidies will still exist.

A lot of changes, a great deal of confusion and a ton of questions. It will take some time but I'm confident that as we get settled into the new system, we'll find some opportunities. And then it will change again :)

2017 Market Performance

Index	*12/3117 Ending Value*	*4Q 2017 Performance*	*Calendar Year2017 Performance*
Dow Jones	**24,719.22**	**10.32%**	**25.08%**
S&P 500	**2,673.61**	**6.12%**	**19.41%**
NASDAQ	**6,903.39**	**6.27%**	**28.24%**
Lehman Aggregate Bond	**109.33**	**<0.23%>**	**1.17 %**



Your Individual Investment Reports

The following reports for Calendar Year 2017 are provided for your review:

- ***2017 Portfolio Performance*** – Compares the month-end percentage performance of the S&P 500 & Lehman Aggregate Bond Index with your portfolio performance.
- ***Quarterly Portfolio Performance vs. CPI*** – Performance of your investment portfolio compared to the rate of inflation as measured by the Consumer Price Index (CPI) for both the since inception period of your accounts and each quarter of 2017.
- ***2017 Asset Performance*** – Performance of each asset within your accounts for the year.
- ***Account Summary*** **–** Current holdings within each account as of 12/31/17.
- ***Investment Billing Statement*** for the 1st Quarter 2018**: Investment advisory fees for the period of 1/1/18 through 3/31/18 (based on 12/31/17 values). *This is an informational billing only.* Your account is automatically debited unless other arrangements have been made.

Please remember that this investment reporting is for informational purposes only. You should also refer to the monthly account statements you receive from TD Ameritrade Institutional.

If you happen to know anyone who might benefit from the services I provide in assisting you in managing your investment portfolio and reaching your financial goals, I would enjoy speaking with them. Don't keep me a secret! ☺ And as always, please do not hesitate to contact me if you have any questions about your reports or wish to discuss any other financial matters.

Sincerely,

Anna M. Popke, CFP®

*Index performance is provided as a benchmark only. The performance of your individual investment portfolio will vary from that of any one index. Past performance of an index is never a guarantee of future results.

PLEASE NOTE: Clients who hold "cash reserves" within their brokerage accounts will have slightly different portfolio balances depicted on the Statement of Assets Summary and the Billing Statement. This is because "cash reserves" are excluded from the advisory fee. However, cash held awaiting investment in the upcoming quarter *will* be subject to the normal quarterly fee.

Investment Advisory Fee Calculations:
Fees are paid in advance on the 7th (or prior closest business day) of the month following the end of the quarter. The amount due is calculated by applying the prorated annual fee percentage to the previous quarter-end account value(s). Fees are further prorated for accounts opened after the beginning of a new quarter. Fees may be paid directly from the investment account(s) or consolidated and paid from a specified account. Money market/cash reserves are excluded from totals. Statements have been prepared by Majestic Oak Financial from information provided by TDAmeritrade and while deemed reliable, are not guaranteed.