TAX REFORM – TCJA – TAX CUTS AND JOBS ACT

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New Individual Tax Rates

- New rate structure with seven tax brackets
  - 10% (same as 2017)
  - 12% (down from 15% in 2017)
  - 22% (down from 25% in 2017)
  - 24% (down from 28% in 2017)
  - 32% (down from 33% in 2017)
  - 35% (same as 2017)
  - 37% (down from 39.6% in 2017)
- Highest rate is applicable to taxable income above $500,000 for single taxpayers and head of household, and $600,000 for married taxpayers filing jointly.

Increased Standard Deduction

- Standard deduction is nearly doubled for 2018 and will be indexed for inflation each year after 2018.
  - Single & Married Filing Separately - $12,000 (up from $6,350 in 2017)
  - Married Filing Jointly - $24,000 (up from $12,700 in 2017)
  - Head of Household - $18,000 (up from $9,350 in 2017)

With these increases (and changes to itemized deductions discussed below) many more taxpayers will take standard deduction rather than itemize.

Suspended Personal Exemption

- Starting in 2018 taxpayers can no longer claim personal or dependency exemptions.
- Note that in 2017 the exemption is subject to a phase-out that begins with adjusted gross incomes of $261,500 ($313,800 for married couples filing jointly). It phases out completely at $384,000 ($436,300 for married couples filing jointly).

Major Changes to Itemized Deductions

- State and local taxes
- Mortgage interest deduction limitation
- Miscellaneous itemized deductions
- Medical expenses
- Overall limitation on itemized deductions

State and Local Taxes

- The itemized deduction for state and local income taxes AND property taxes combined is limited to a total of $10,000 starting in 2018.

Mortgage Interest Deduction Limitations

- Mortgage interest on loans used to acquire a principal residence and a second home is only deductible on debt up to $750,000 (down from $1 million), starting with loans taken out as of 12/15/17.
  - Loans used to acquire a principal residence and a second home in place prior to 2018 will keep the $1 million dollar limitation.
  - Note the limitation is per taxpayer which increases the limitation for single co-owners / registered domestic partners.
- There is no longer any deduction for interest on home equity loans, regardless of when the debt was incurred.

Miscellaneous Itemized Deductions

- There is no longer a deduction for miscellaneous itemized deductions which were formerly deductible to the extent they exceeded 2 percent of adjusted gross income.
- The items no longer deductible are:
  - tax preparation costs
  - investment expenses
  - union dues
  - unreimbursed employee expenses

Medical Expenses

- For 2017 and 2018, medical expenses are deductible to the extent they exceed 7.5 percent of adjusted gross income for all taxpayers.
- Previously, the AGI "floor" was 10% for most taxpayers and will return to 10% for tax years after 2018.

Overall Limitation on Itemized Deductions

- The new law suspends the overall limitation on itemized deductions that formerly applied to taxpayers whose adjusted gross income exceeded specified thresholds (e.g. $261,500 for single and $313,800 for married filing joint in 2017).
- The itemized deductions of such taxpayers were reduced by 3% of the amount by which AGI exceeded the applicable threshold, but the reduction could not exceed 80% of the total itemized deductions, and certain items were exempt from the limitation.

Other Individual Changes

- Alimony
  - For post-2018 divorce decrees and separation agreements, alimony will not be deductible by the paying spouse and will not be taxable to the receiving spouse.
- Moving Expenses
  - The deduction for job-related moving expenses has been eliminated, except for certain military personnel.
- Health care "individual mandate.“
  - Starting in 2019, there is no longer a penalty for individuals who fail to obtain minimum essential health coverage.

Other Individual Changes continued

- Estate and gift tax exemption.
  - Effective for decedents dying, and gifts made, in 2018, the estate and gift tax exemption has been increased to roughly $11.2 million ($22.4 million for married couples).
- Child and family tax credit.
  - Credit increased to $2,000 from $1,000 and increases to $1,400 the refundable portion of the credit. Also includes a new (nonrefundable) $500 credit for a taxpayer's dependents who are not qualifying children.
- Casualty and theft losses.
  - The itemized deduction for casualty and theft losses has been suspended except for losses incurred in a federally declared disaster.

SECTION 199A – 20% DEDUCTION – 2018 - 2025

- FOUR MAIN FACTORS
  - DO YOU HAVE QBI
  - WHAT IS YOUR TAXABLE INCOME
  - W-2 WAGES AND UNADJUSTED BASIS OF QUALIFIED PROPERTY
  - SPECIFIED SERVICE TRADE OR BUSINESS
- IT'S NOT GUARANTEED – SUBJECT TO
  - LIMITATIONS
  - TERMS OF ART
  - THRESHOLDS
  - PHASE INS AND OUTS AND
  - A CRITICAL DEFINITION

WHO GETS TO TAKE THE DEDUCTION

- AVAILABLE TO ALL TAXPAYERS OTHER THAN A CORPORATION

WHAT IS QUALIFIED BUSINESS INCOME

- ORDINARY INCOME LESS ORDINAY DEDUCTIONS YOU EARN FROM A SOLE-PROPRIETORSHIP, S CORPORATION, OR PARTNERSHIP
- DOES NOT INCLUDE WAGES YOU EARN AS AN EMPLOYEE OR GUARANTEED PAYMENTS
- IT DOES NOT INCLUDE THE FOLLOWING:
  - SHORT TERM CAPITAL GAIN
  - LONG TERM CAPITAL GAIN
  - DIVIDEND INCOME
  - INTEREST INCOME

WHAT CONSTITUES BUSINESS

- NOT WELL DEFINED
- MAY FALL UNDER IRC SECTION 162 – REGULAR, CONTINUOUS, AND SUBSTANTIAL.

2nd Decision

- LESSER OF
  - 20% OF THE TAXPAYER'S "QUALIFIED BUSINESS INCOME" OR
  - THE GREATER OF:
    - 50% OF THE W-2 WAGES WITH RESPECT TO THE BUSINESS, OR
    - 25% OF THE W-2 WAGES WITH RESPECT TO THE BUSINESS PLUS 2.5% OF THE UNADJUSTED BASIS OF ALL QUALIFIED PROPERTY.

WHAT ARE WAGES?

- YOUR “ALLOCABLE SHARE” OF WAGES
  - S corp – allocated pro-rata, on a per-share/per-day basis
  - Partnership – same manner as wage deduction – follow box 1
- 401(k) elective deferrals included
- Management fees and payments to independent contractors do not count – have to show up on a payroll tax return.

WHAT IS UNADJUSTED BASIS OF QUALIFIED PROPERTY?

- QUALIFIED PROPERTY – ANY TANGIBLE PROPERTY SUBJECT TO DEPRECIATION (NOT INVENTORY) – HELD BY BUSINESS AT END OF YEAR AND USED AT ANY POINT DURING YEAR IN THE PRODUCTION OF QBI.
  - TAKE INTO ACCOUNT THE LATER OF
    - 10 YEARS OR
    - THE LAST DAY OF THE FULL YEAR IN THE ASSET'S REGULAR (NOT ADS) DEPRECIATION PERIOD.

  - EXAMPLE – 5 YEAR COMPUTER

UNADJUSTED BASIS OF QUALIFIED PROPERTY

- NOTES
  - “UNADJUSTED BASIS” – NOT REDUCED BY DEPRECIATION DEDUCTIONS
  - ONLY TAKE INTO ACCOUNT HIS OR HER ALLOCABLE SHARE
  - THE 2.5% PART OF THE COMPUTATION WAS TO BENEFIT RENTAL REAL ESTATE.

EXCEPTION TO THE W-2 WAGE LIMITATION

- IF YOUR TAXABLE INCOME IS LESS THAN THE FOLLOWING THRESHOLDS, YOU CAN IGNORE THE W-2 BASED LIMITATIONS:
  - MARRIED - $315,000
  - ALL OTHER TAXPAYERS - $157,500

PHASE IN OF W-2 LIMITATION

- ONCE YOU EXCEED THE TAXABLE INCOME LIMITS
  - MFJ - $315K
  - ALL OTHERS - $157,500

YOU HAVE TO START FACTORING IN THE W-2 LIMITATIONS, BUT NOT ALL AT ONCE:

PHASE IN:

- MFJ – OVER THE NEXT $100K OF INCOME
- ALL OTHERS – OVER THE NEXT $50K OF INCOME

EXCESS AMOUNT – GET OUT OF JAIL FREE CARD – DIFFERENCE BETWEEN 20% AND W-2 LIMITATION. PHASE OUT OF THIS AMOUNT

WHAT BUSINESSES ARE ELIGIBLE

- TRADES OR BUSINESSES THAT ARE NOT ELIGIBLE FOR THE 20% QBI DEDUCTION:
  - ANY SPECIFIED SERVICE TRADE OR BUSINESS –TRADE OR BUSINESS INVOLVING THE PERFORMANCE OF SERVICES
    - HEALTH *ACTUARIAL SCIENCE
    - LAW *PERFORMING ARTS
    - ~~ENGINEERING~~ *CONSULTING
    - ~~ARCHITECTURE~~ *ATHLETICS
    - ACCOUNTING *FINANCIAL & BROKERAGE SERVICES

ADDITIONAL BUSINESSES NOT ELIGIBLE

- INVESTING AND INVESTMENT MANAGEMENT
- TRADING, OR
- DEALING IN SECURITIES, PARTNERSHIP INTERESTS, OR COMMODITIES

OVERALL LIMITATION

- LESSER OF
  - COMBINED “QUALIFIED BUSINESS INCOME” (20% DEDUCTION)
  - 20% OF THE EXCESS OF TAXABLE INCOME MINUS THE SUM OF ANY NET CAPITAL GAIN

PUTTING IT ALL TOGETHER

- TAXABLE INCOME IS A BIG DEAL FOR TWO REASONS:
  – FIRST, $1 OVER $157,500 OR $315,000 STARTS THE SPECIFIED SERVICE BUSINESS DISQUALIFICATION AND W-2 LIMITATION.
  – SECOND, THE 199A DEDUCTION IS LIMITED BY 20% OF TAXABLE INCOME FROM ALL SOURCES (IN EXCESS OF CAPITAL GAIN).

SECTION 199A DECISION TREE

- SPECIFIED SERVICE TRADE OR BUSINESS
  - IF TAXABLE INCOME IS LESS THAN $157,500/$315,000 THEN THE 20% DEDUCTION IS FULLY AVAILABLE.
  - IF TAXABLE INCOME IS GREATER THAN $157,500/$315,000 BUT LESS THAN $207,500/$415,000 THEN A PARTIAL DEDUCTION IS AVAILABLE.
  - IF TAXABLE INCOME IS GREATER THAN $207,500/$415,000 THEN DEDUCTION IS NOT AVAILABLE

SECTION 199A DECISION TREE

- ALL OTHERS
  - IF TAXABLE INCOME IS LESS THAN $157,500/$315,000 THEN THE 20% DEDUCTION IS FULLY AVAILABLE.
  - IF TAXABLE INCOME IS GREATER THAN $157,500/$315,000 BUT LESS THAN $207,500/$415,000 THEN A PARTIAL DEDUCTION IS AVAILABLE WITH THE W-2 AND THE DEPRECIABLE ASSET LIMIT CALCULATIONS PHASE IN.
  - IF TAXABLE INCOME IS GREATER THAN $207,500/$415,000 THEN THE 20% DEDUCTION IS COMPARED TO THE FULL W-2 AND DEPRECIABLE ASSET LIMIT CALCULATIONS.

FACTS ABOUT THE 20% DEDUCTION

- TAKEN ON PAGE 2 OF FORM 1040 – NOT PART OF ITEMIZED DEDUCTION
- WILL NOT REDUCE SE INCOME
- SHOULD BE ABLE TO TAKE INTO ACCOUNT WHEN CALCULATING AMT
- QBI LOSS CARRIES OVER TO YEAR 2 IN COMPUTING THE 20% OF QBI
- NOL’S DO NOT INCLUDE THE 199A DEDUCTION

EXAMPLES

- C CORP VS S CORP
- SOLE PROPRIETOR VS S CORP VS PARTNERSHIP

BUSINESS INCOME TAX PROVISIONS

- CORPORATE TAX RATE IS REDUCED TO A FLAT 21% - INCLUDES PSC'S
- CORPORATE AMT IS REPEALED
- DRD IS REDUCED:
  - 70% TO 50%
  - 80% TO 65%
- DPAD IS REPEALED FOR C CORPS
- THE TECHNICAL TERMINATION RULE IS REPEALED FOR ANY SALE OR EXCHANGE OF 50% OR MORE OF THE PARTNERSHIP'S CAPITAL AND PROFITS INTERESTS DURING A 12 MONTH PERIOD.

DEPRECIATION PROVISIONS

- MAXIMUM IRC SECTION 179 IS INCREASED TO $1,000,000 WITH PHASE-OUT ACQUISITION LIMITATION BEGINNING AT $2,500,000.
- THE DEFINITION OF QUALIFIED REAL PROPERTY ELIGIBLE FOR 179 EXPENSING KNOW INCLUDES ANY OF THE FOLLOWING IMPROVMENTS TO NONRESIDENTIAL REAL PROPERTY:
  - ROOFS
  - HEATING
  - VENTILATION
  - AIR CONDITIONING PROPERTY
  - FIRE PROTECTION
  - ALARM AND SECURITY SYSTEMS

ADDITIONAL DEPRECIATION PROVISIONS

- A 15 YEAR RECOVERY PERIOD APPLIES FOR QUALIFIED IMPROVEMENT PROPERTY.
- BONUS DEPRECIATION
  - 50% FROM 1/1/17-9/27/17
  - 100% FROM 9/28/17 – 12/31/22
  - ALSO REMOVES THE REQUIREMENT THAT THE ORIGINAL USE MUST START WITH THE TAXPAYER.

NOL'S AFTER 2017

- NOL DEDUCTION IS LIMITED TO 80% OF TAXABLE INCOME FOR LOSSES ARISING IN TAXABLE YEARS AFTER 12/31/17.
- 2 YEAR CARRYBACK IS REPEALED (EXCEPTION FOR FARMING)
- NOL CAN CARRYFORWARD INDEFINITELY

BUSINESS INTEREST

- THE DEDUCTION FOR BUSINESS INTEREST IS LIMITED FOR EVERY TAXPAYER (REGARDLESS OF FORM)
  - 30% OF THE ADJUSTED TAXABLE INCOME OF THE TAXPAYER FOR THE YEAR

IT APPLIES AT THE TAXPAYER LEVEL AND FOR PASS-THRU ENTITIES, AT THE ENTITY LEVEL

UNUSED AMOUNT MAY BE CARRIED FORWARD INDEFINITELY

ADJUSTED TAXABLE INCOME IS COMPUTED WITHOUT REGARD TO

- DEPRECIATION

- AMORTIZATION

- OR DEPLETION

THE LIMITATION DOES NOT APPLY TO TAXPAYERS WITH AVERAGE ANNUAL GROSS RECEIPTS OF $25 MILLION OR LESS FOR THE 3 YEAR PERIOD ENDING WITH THE PRIOR TAX RETURN

REAL PROPERTY TRADESS OR BUSINESS – ELECTION TO NOT HAVE INTEREST DEDUTION RULES APPLY IF ELECT TO USE ADS.

MISCELLANEOUS

- LIKE-KIND EXCHANGES – ONLY APPLY TO REAL PROPERTY AFTER 2017
- NO DEDUCTION IS ALLOWED FOR ENTERTAINMENT EXPENSES AFTER 2017
- 50% DEDUCTION UNDER IRC SECTION 274 IS STILL ALLOWED