Navigating Tax Reform

• Provisions for Businesses
  – Tax Rates, C vs. S, AMT, & DRD
  – Depreciation Changes
  – Business Interest Expense Limitations
  – Business Loss Provisions (Corp. & Individual)
  – 1031 Exchanges and Sec 118 Contributions by Nonshareholders
  – Nondeductible Entertainment
  – Passthrough Business Deduction
  – Q&A
Navigating Tax Reform (If we have time)

• Provisions for Individuals
  – Tax Rates & Credits
  – Itemized Deductions
  – AMT Changes (NOT REPEALED FOR INDIVIDUALS)
  – Estate Tax Law Changes
  – Healthcare Mandate
Is this Really Tax Simplification?

MAKE IT SIMPLE

Tax Reform
Not Even the Name is Simple...

Was:  
“The Tax Cuts & Jobs Act”

Now: 
“To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018”

* Changing the name to the shorter version violated a guideline called “The Byrd Rule.”
Provisions for Businesses
Corporate Taxes

- Flat 21% rate effective years beginning after 2017
  - **Repealed:** Higher tax rate on Personal Service Corps (PSC)
  - Fiscal year end taxpayers:
    ◊ Will file using a blended rate of prior law and current law
### Use of C Corporation vs. Pass-thru Entity

#### Double Taxation of Income

<table>
<thead>
<tr>
<th></th>
<th>Double Taxation of Marginal Earnings</th>
<th>S Corp. Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1120</strong></td>
<td></td>
<td><strong>1040</strong></td>
</tr>
<tr>
<td>Net income (&gt;W-2/rent)</td>
<td>$ 1.00</td>
<td></td>
</tr>
<tr>
<td>– Corp. tax</td>
<td>(.21)</td>
<td></td>
</tr>
<tr>
<td>Net in corp.</td>
<td><strong>.79</strong></td>
<td></td>
</tr>
<tr>
<td>Sale/liquidation/</td>
<td></td>
<td></td>
</tr>
<tr>
<td>redemption</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less 23.8% LTCG/div. (no 1202)</td>
<td>(.19)</td>
<td></td>
</tr>
<tr>
<td>Less top 1040 rate (37%)</td>
<td></td>
<td>(.296)</td>
</tr>
<tr>
<td>after 20% subtraction</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net after tax</td>
<td><strong>$.60</strong></td>
<td><strong>$.704</strong></td>
</tr>
</tbody>
</table>
## Use of C Corporation vs. Pass-thru Entity

Double Taxation of Intangible Asset Gain

<table>
<thead>
<tr>
<th>Double Taxation of Inside Gain</th>
<th>S Corp. Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1120</td>
<td>1040</td>
</tr>
<tr>
<td>1040</td>
<td>1040</td>
</tr>
<tr>
<td>$1.00</td>
<td>$1.00</td>
</tr>
</tbody>
</table>

| Capital gain on sale | $1.00 |
| Corp. tax            | (.21)  |
| Net in corp.         | .79    |

| Sale/liquidation/ redemption | $ .79 |
| Less 23.8% LTCG/div. (no 1202) | (.19) |

| Less 1040 capital gain rate if MP | .20 |
| Net after tax                     | .60 | .80 |
Corporate AMT Repealed

- 20% corporate AMT repealed for taxable years beginning after December 31, 2017
- Minimum Tax Credit refundable up to 50% of the excess of AMT credits > regular tax liability for 2018-2020
- Refund excess 2021
Dividend Received Deduction

- **80% becomes 65%**
  - Dividend received by 20% or more owned corporation
  - Effective tax of 7.35%

- **70% becomes 50%**
  - Effective tax of 10.5%
## Section 179 Amounts: Extender Legislation

<table>
<thead>
<tr>
<th>Tax yr. <em>beginning</em> in</th>
<th>Sec. 179 Limit</th>
<th>Asset Addn. Phase-out Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$125,000</td>
<td>$500K - $625K</td>
</tr>
<tr>
<td>2008-2009</td>
<td>$250,000</td>
<td>$800K - $1.05M</td>
</tr>
<tr>
<td>2010-2014</td>
<td>$500,000</td>
<td>$2M - $2.5M</td>
</tr>
<tr>
<td>2015</td>
<td>$500,000</td>
<td>$2M - $2.5M</td>
</tr>
<tr>
<td>2016 - 2017</td>
<td>Permanent (plus indexed)</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>$1 M</td>
<td>$2.5M - $3.5M</td>
</tr>
</tbody>
</table>

(Indexed for Inflation)
Sec. 179 “Qualified Property”

- Expand Sec. 179 to roofs, HVAC, fire protection and alarms systems, security systems
  - Nonresidential real property
  - Placed in service after building placed in service
Bonus Depreciation

- Expense 100% acquired and placed in service >9-27-17 and before 2023 (only retroactive provision)
  - Includes new and used
  - Drops bonus to 80% in 2023, 60% in 2024, 40% in 2025, 20% in 2026, then zero
  - Delay phase-out by 1 year for longer production prop.
- Transition rule allows 50% for first taxable year ending after 9-27-2017
- Election to accelerate AMT credits in lieu of bonus depreciation repealed
Building Depreciation

- Retains 39-year and 27.5 year provisions
- Eliminates separate definitions of 15 year property
  - Qualified leasehold improvement property
  - Qualified restaurant property
  - Qualified retail improvement property
- Focus is on qualified improvement property
  - Improvements to interior portion of building
  - Nonresidential
  - Placed in service after date building placed in service
  - Straight-line 15 year, with 20-year ADS
- Residential rental ADS period becomes 30 years
Expansion of Cash Method of Accounting

- All businesses with average gross receipts < $25 million permitted to use cash method
  - But account for inventories as non-incidental supplies (hold cost until sold)
  - Manufacturers: use Rev. Proc. 2001-10 at higher receipts?
  - Exempt 263A (UNICAP), including real estate construction
- May use completed contract method if < 2 years
- Automatic consent accounting method change
Disallowed Business Interest Expense

• Interest expense limited to interest income plus 30% of remaining adjusted taxable income
  – Floor plan interest also allowed
  – Financing for motor vehicles, boats, farm machinery

• Determined at entity level

• Remaining business adjusted taxable income
  – Determined w/o interest income, NOL, 199A, depreciation, amortization, depletion
  – After 2021, depreciation etc. not added back
  – Determined at tax filer level (1065, 1120-S)
  – Excess carried forward to succeeding five years
Exceptions to Business Interest Expense

• No disallowance for business with average gross receipts < $25 million

• Elections out available:
  – Real estate professionals
  – Farming business
Partnership Interest Expense Limits

- Partner can deduct additional interest expense to the extent the partnership could have deducted
  - Also applies to S corporation shareholder
  - Should allow interest expense to acquire ownership to be part of computation
Business Loss Provisions

- Repeal NOL carrybacks
  - Two-year carryback for farms (no disaster provision)
  - Carryforwards: No limit

- Post-2017 NOL’s
  - c/o allowed to 80% of taxable income

- Corporate Pre-2017 NOL’s
  - No AMT limits (AMT Repealed)
  - 20 Year Carryforward remains unchanged
Individual Business Loss Provisions

- Noncorporations only
- Net business loss limited to $500K jt./$250K single
- Applied at 1040 level
- Excess is treated as NOL c/o
- Farm loss limitation repealed
Section 199

- REPEALED after 2017
  - Fiscal year C corporations receive benefit of Sec. 199 together with blended income tax rates
Other Business Changes

• Section 1031 exchanges for only real property
  – Personal property exchanges taxable; but asset expensing offsets the gain
  – Can’t avoid Sec. 1374 BIG tax by trading equipment

• Sec. 118 non-owner contrib. to capital is taxable
  – Contribution in aid of construction
  – Contribution by a customer or potential customer
  – Contribution by governmental entity or civic group

• Deductions denied for local lobbying
  – Appearances, submission of statements, portion of dues to lobbying organizations
Disallowance of Entertainment

• No deduction for entertainment
  – Transportation passes and parking fringes disallowed
  – Social, athletic and sporting clubs treated as entertainment
Business Credits Retained

- Employer-provided child care credit
- 20% historic rehab credit over five years
  - Repeal 10% pre-1936 building rehab credit
- WOTC (jobs credit)
- Deduction for unused business credit > 20 years
- New markets cr. (community development entity)
- Disabled access credit
20% Deduction for Passthrough Income

• Individuals, estates, and trusts may deduct 20% of domestic **qualified** business income from a PS, S Corp, or Sole Proprietorship (SP)

• Deduction is only for **certain** businesses
  ◊ That pay W-2 wages or
  ◊ Have machinery, equipment, etc.
  ◊ Deduction does not apply to companies that provide services

• Deduction is not applied to W-2 income or guaranteed payments paid to owner; only to flow-through income

• Deduction does not apply to investment income
20% Deduction:  
Business Deduction Limitation

- If Taxable income is greater than $315k;
  - Taxpayer deduction is limited to greater of:
    ◇ 50% of wages paid, or
    ◇ Sum of 25% of wages plus 2.5% of unadjusted basis of qualified property

- Qualified property
  - Depreciable tangible property on hand at end of year
  - Used in the production of qualified business income
  - “Depreciable period” has not ended before year end
20% Deduction:

“Depreciable Period” Defined

- **Starts:**
  - Date property is placed in service
- **Ends:**
  - Later of
    - 10 years after the start date, or
    - The last day of the last full year of depreciation

Do we need to keep track of the cost of fully depreciated assets for 10 years?

Tax Simplification?
20% Deduction: Exceptions to the Exceptions

- **General Rule:** TP can only take deduction if business has W-2 wages/guaranteed payments or PP&E, and is not a service company

- **Exception:** All limitations do not apply if TP income is below
  - $315k for MFJ, or
  - $157.5k for other taxpayers

- **Phaseout:** Deduction phases out for Professional Service Providers at 20% as follows:
  - $315k – 415k for MFJ
  - $157.5k - $207.5k for other taxpayers
20% Deduction: Personal Service Business Defined

- **No** 20% deduction for higher income personal service businesses
  - Includes Health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, & brokerage services
    - Unless income is below the $315k/$157.5k threshold
  - Also includes:
    - “any other trade or business where the principal asset ... is the reputation or skill of one or more of its employees”
- **Personal service does not include architects & engineers**
20% Deduction: Qualified Business Income (QBI) Defined

- Net amount of domestic income from all **qualified** businesses
  - If net is a loss, the loss reduces QBI in the next year
  - QBI includes the following:
    - Dividend income from a REIT
    - Dividends from qualified cooperatives
    - Dividends from publicly traded partnerships

- QBI does **NOT** include wages/guaranteed payments paid to TP

- **Personal service businesses** are **NOT** qualified businesses
20% Deduction : Other Rules

• Allowed against AMT income
• Not a deduction to arrive at AGI
  – Does not reduce AGI for purposes of AGI thresholds
  – Allowed to non-itemizers
• Does not reduce income for application of the Net Investment Income tax (3.8%)
• Appears to apply to qualified passive business income
Questions?
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Principal
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972-383-5756
Provisions for Individual Taxpayers
New Rate Schedule for MFJ

- Below $19,050 = 10%
- $19,051 to $77,400 = 12%
- $77,401 to $165,000 = 22%
- $165,000 to $315,000 = 24%
- $315,001 to $400,000 = 32%
- $400,001 to $600,000 = 35%
- Above $600,000 = 37%
## Comparison of MFJ Rates: Old 2017 Rates* vs. Tax Act

<table>
<thead>
<tr>
<th>Income range</th>
<th>2017 Rates*</th>
<th>Tax Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1 to $19,050</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>$19,051 to $77,400</td>
<td>15%</td>
<td>12%</td>
</tr>
<tr>
<td>$77,401 to $156,150</td>
<td>25%</td>
<td>22%</td>
</tr>
<tr>
<td>$156,150 to $165,000</td>
<td>28%</td>
<td>22%</td>
</tr>
<tr>
<td>$165,001 to $237,950</td>
<td>28%</td>
<td>24%</td>
</tr>
<tr>
<td>$237,951 to $315,000</td>
<td>33%</td>
<td>24%</td>
</tr>
<tr>
<td>$315,001 to $400,000</td>
<td>33%</td>
<td>32%</td>
</tr>
<tr>
<td>$400,001 to $424,950</td>
<td>33%</td>
<td>35%</td>
</tr>
<tr>
<td>$424,950 to $480,050</td>
<td>35%</td>
<td>35%</td>
</tr>
<tr>
<td>$480,051 to $600,000</td>
<td>39.6%</td>
<td>35%</td>
</tr>
<tr>
<td>Over $600,000</td>
<td>39.6%</td>
<td>37%</td>
</tr>
</tbody>
</table>

* - 2017 Rates Adjusted for Inflation
Other Rates

• Single rate schedule = ½ MFJ breakpoints
  – 37% bracket starts at $500,000

• Heads of Households
  – 10% up to $13,600 (v. $19,050 for MFJ)
  – 12% over $13,600 to $51,800 (v. $77,400 MFJ)
  – 22% over $51,800 to $82,500 (v. $165,000 MFJ)
  – 24% over $82,500 to $157,500 (v. $315,000 MFJ)
  – 32% over $157,500 to $200,000 (v. $400,000 MFJ)
  – 35% over $200,000 to $500,000 (v. $600,000 MFJ)
  – 37% over $500,000
Capital Gains: Preserve Present System

The system: Ordinary fills the lower brackets first, then capital gains on top. Deductions offset ordinary.
# Standard Deduction & Personal Exemption: 2018

<table>
<thead>
<tr>
<th>Standard Deduction</th>
<th>2017</th>
<th>2018 Tax Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFJ</td>
<td>$12,700</td>
<td>$24,000</td>
</tr>
<tr>
<td>Single</td>
<td>$6,350</td>
<td>$12,000</td>
</tr>
<tr>
<td>HoH</td>
<td>$9,350</td>
<td>$18,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Personal Deduction</th>
<th>2017</th>
<th>2018 Tax Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFJ</td>
<td>$8,100*</td>
<td>$0</td>
</tr>
<tr>
<td>Single</td>
<td>$4,050</td>
<td>$0</td>
</tr>
<tr>
<td>HoH</td>
<td>$8,100*</td>
<td>$0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Deduction</th>
<th>2017</th>
<th>2018 Tax Act</th>
<th>True Increase in Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>MFJ</td>
<td>$20,800*</td>
<td>$24,000</td>
<td>$3,200</td>
</tr>
<tr>
<td>Single</td>
<td>$10,400</td>
<td>$12,000</td>
<td>$1,600</td>
</tr>
<tr>
<td>HoH</td>
<td>$17,450*</td>
<td>$18,000</td>
<td>$550</td>
</tr>
</tbody>
</table>

* - Assumes 2 Personal Exemptions are Claimed
Kiddie Tax

• **2017:**
  - Unearned Kiddie income taxed at higher of:
    ◊ Parents’ marginal rate after adding in sibling income, or
    ◊ Child’s tax rate

• “Kiddie” Defined:
  - Child under the age of 19 and
  - College students under the age of 24

• **2018:**
  - Kiddie tax to use estate and trust rates
  - No longer tied to parents’ marginal rate
  - No longer affected by income of siblings
Child and Family Tax Credits

- Child credit: Increase from $1,000 to $2,000
  - No change to “qualifying child” definition: < age 17
- Plus $500 credit for each taxpayer/spouse & dependent not a qualifying child for $2,000 credit
- Refundable portion increased to $1,400
- Phase-out begins at
  - MFJ - $400k (up from $110K);
  - Single at $200,000 (up from $75K)
Education Provisions

• Retained
  – Coverdell Ed Savings Account
  – Interest expense on education loans
  – Exclusion for employer-provided ed assistance
  – Exclusion for US savings bond used for higher ed
  – Deduction for qualified tuition and related expenses
  – Exclusion for qualified tuition reduction programs

• Added
  – Elementary and high school tuition up to $10,000/year qualified for 529 plan withdrawals
  – Student Loan Discharge is excluded from income if due to death or total/permanent disability
Changes to Itemized Deductions
Overall Itemized Deductions & Home Mortgage Interest

- **Repealed:**
  - Overall Itemized Deduction Phaseout
  - Home equity loan interest deduction

- **Changed:**
  - For new debt incurred after 12-14-17:
    - Deduct interest on home acquisition debt up to $750,000
      - Was $1M
    - Retains provisions for second home interest deduction
      - Up to $750k debt limit, in total
  - **Grandfathered:** Home debt incurred before 12-15-17 (even if refinanced)
Deduction for Taxes

• Itemized deductions for taxes limited to $10,000
  – State & local income tax or
  – sales tax, plus
  – U.S. real property tax
  – No deduction for foreign RE tax

• 2017 strategies:
  – Real estate tax paid for 2018 in 2017:
    ◊ *Tax must be assessed*
  – **Caution**: AMT may negate federal benefit;
Casualty & Theft Losses

- **Repealed:**
  - Deduction for casualty losses
  - **Exception:** Unless casualty results from a federally-declared disaster

- **Clarification of gambling losses**
  - Losses **and expenses** are limited to winnings

- **Not Clear:**
  - Deductibility of theft loss
Charitable Deductions

- **New:** 50%-of-AGI limit increased to 60%
- **Repealed:** Deduction for payment to higher education institution for rights to purchase tickets to athletic events (prior law allowed 80% deduction)
- **Retained:** Exclusion for contribution of IRA to charity for people over 70.5 years old
  - Avoids % limit on charitable contributions
  - Avoids increase in AGI
  - Get benefit when not itemizing

(p. 19-12)
Repealed:

Miscellaneous Itemized Subject to 2%

• Repeals all misc. itemized ded subject to 2% floor

• Examples include
  – Employee business expenses (!)
  – Investment expense
  – Uniforms and work clothes
  – Tax preparation fees (!!!)
  – Professional dues
  – Hobby loss expenses
  – Home office for employee (!!!!)
  – Tools/supplies for taxpayer’s work
  – Safe Deposit Box

(p. 19-13)
Medical and Other Deductions

- Medical exp in excess of 7.5% of AGI is deductible
  - For 2017 & 2018 only (10% floor starting in 2019)
  - Retroactive change for 2017 (was 10% floor)
  - Deductible for AMT also

- **Repealed:** Alimony deduction
  - Effective for divorce decrees executed after 2018

- **Repealed:** Moving expense deduction
  - Except for active duty military, pursuant to military order, incident to permanent change of station

- **Retained:** Archer Medical Savings Account
Summary: Itemized Not Repealed

• Medical in excess of 7.5% AGI
• Taxes limited to $10,000
• Home mortgage interest on principal residence and second home
  – New debt limit: $750K
• Investment interest expense limited to inv. income
• Charitable contributions
• Non-2% miscellaneous itemized deductions
  – Except casualty losses
Changes to Alternative Minimum Tax (AMT)

- Exemption amount increased:
  - MFJ - $109,400 (up from $86,200)
    - MFS is half of the above (up from $43,100)
  - All other taxpayers - $70,300 (up from $54,700)

- Start of Phase-out of Exemption increased:
  - MFJ - $1 million (up from $164,100)
    - MFS is half of the above (up from $82,050)
  - All other taxpayers - $500k (up from $123,100)
Estate & Gift Tax

- **Exclusion Doubled: $5M to $10M + indexing**
  - Deaths in 2017: Exclusion is $5,490,000
  - Should be $11.2 million for 2018
  - Maintain stepped-up basis
  - Gift/Estate tax rate remains unchanged (40%)

- **Retain annual gift tax exclusion**
  - $15K for 2018
  - $14k for 2017
Affordable Care Act Changes

• Prior Law:
  – If individual does not have minimum coverage, he will be subject to a tax
  – Called “Shared Responsibility Tax”

• New Law:
  – Shared Responsibility Tax is repealed
  – Starting in 2019
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