Bowles Rice

Breaking Down the

Tax Cuts & Jobs Act of 2017

“Tax Avoidance is Good”

“Anyone may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that path which will best pay the treasury; there is not even a patriotic duty to increase one’s taxes.”

Gregory v. Helvering, 69 F.2d 809 (2nd Cir. 1934)

Disclaimers

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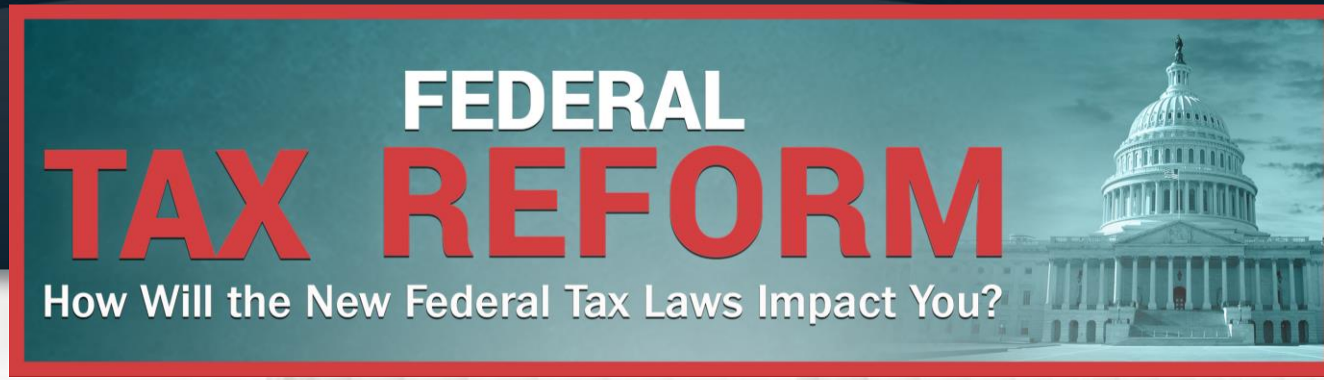

The Tax Cuts and Jobs Act (TCJA) made sweeping changes to Federal tax laws for individuals and businesses, beginning in 2018.

Members of the **Bowles Rice Tax Team** have compiled the following summaries to help you learn more.

Invisible Boomerangs

- "It is obvious to this court that the IRC is incomprehensible without the assistance of a qualified expert in tax law. This conclusion is best supported by a short and snappy comment from Justice Jackson, once Chief Counsel for the IRS, in a dissenting opinion in *Arrowsmith v. Commissioner of Internal Revenue*, 344 U.S. 6, 12, 73 S.Ct. 71, 97 L.Ed. 6 (1952); where he referred to federal taxation as a 'field beset with invisible boomerangs.'" *Donahue's Accounting and Tax Service, S.C. v. Ryno,* 674 N.W.2d 681 (Wisc. App. 2003)

TCJA Impact on Individuals – Summary

- Generally, Lower Tax Rates.
- Increase in Standard Deduction to $12,000 and $24,000.
- Personal exemptions eliminated.
- Phase-out of itemized deductions for high-income eliminated.
- Changes to mortgage and HELOC interest deduction.
- Change in alimony treatment.
- 50% of AGI limitation for cash contributions to charities increased to 60%.
- Charitable deduction for payment to university in exchange for right to purchase tickets to an athletic event eliminated.

TCJA Impact on Individuals – Summary (cont.)

- Misc. itemized deductions subject to the 2% floor (e.g. tax prep fees) are suspended.
- Qualified Business Income Deduction.
- Increase in Child & Family Tax Credit.
- State and local income and property taxes. deduction limited.
- Health Care “Individual Mandate” penalty removed in 2019.
- Estate and Gift Tax exemption increased.
- Floor for medical expense deduction lowered.

TCJA Impact on Business – Summary

- Corporate tax rates reduced.
- Dividends-received deduction for corporations owning at least 20% of the dividend-paying company from 80% to 65% of the dividends, and for corporations owning under 20% from 70% to 50%.
- Alternative minimum tax repealed.
- NOLs arising after 2017 can only be carried forward, not back, and are limited to 80% of taxable income. Two-year carryback and unlimited carry forward allowed for certain farming losses.
- Business interest deduction limited to 30% of adjusted taxable income for businesses with average annual gross receipts of over $25 Mill. Amount disallowed carried forward indefinitely.
- Domestic production activities deduction repealed.

TCJA Impact on Business – Summary (cont.)

- New fringe benefit rules, incl. no deduction for business-related entertainment expenses.
- No deduction for local lobbying expenses.
- Increased Code Sec. 179 expensing.
- Bonus depreciation.
- Depreciation of qualified improvement property - 15-year recovery period and straight-line method.
- Depreciation of farming equipment and machinery - cost recovery period reduced from 7 to 5 years 200% declining balance method in place of the 150% declining balance method.
- Luxury auto depreciation limits increased.
- Excessive employee compensation.

Qualified Business Income (QBI) Deduction

- A significant new tax deduction – equal to 20% of "qualified business income (QBI)" from a partnership (incl. LLC), S corp or sole proprietorship. IRC §199A.
- Business must be conducted within the U.S. to qualify.
- Investment-related items (such as e.g., capital gains or losses, dividends, and interest income) are NOT included.
- Does not apply to wages or salary of an employee (even if also a shareholder), or guaranteed payment to a partner.
- The deduction is taken "below the line."
- Not affected by whether you itemize or take standard deduction.

Qualified Business Income (QBI) Deduction (cont.)

- Phase out and limitations
  - Service Businesses – incl. health, law, accounting, financial
    - ratable reduction or elimination of deduction
    - taxable income above $157,500 ($315,000 for joint filers) to
    - taxable income above $207,500 ($415,000 for joint filers)
  - All Other Businesses
    - taxable income above $207,500 ($415,000 for joint filers)
    - Limit on amount of deduction to greater of:

      50% of allocable share of W-2 wages paid by business, or

      Sum of 25% of such wages plus 2.5% of the unadjusted basis of tangible depreciable property used in the business (including real estate).

Changes to Corporate and Individual Tax Rates and Brackets

- Changes effective at beginning of 2018.
- New individual ordinary income rates and brackets.
- Future brackets adjustments will understate inflation.
- Capital Gain rates and brackets generally the same.
- These new tax rates WILL NOT affect CY 2017 return.
- They will immediately affect the amount of wage withholding (see Notice 1036) and the amount, if any, of estimated tax that you pay.
- Flat Corporate Income Tax rate of 21% (non-calendar year C corps – see IRC § 15(a)).
- Elimination of corporate AMT.
- Increase in individual AMT exemption.

Changes to the Estate and Gift Tax Exemption

- Changes will result in fewer estates being subject to the 40% tax, and larger estates owing less tax.

- The TCJA doubles the base gift, estate and GST tax exemption from $5 Mill. to $10 Mill. (indexed for inflation).

Individuals' Itemized Deductions of Non-Business Taxes

- Prior to the TCJA, taxpayers could claim various state, local and foreign real and personal property taxes and income/profits taxes as itemized deductions, even if they were not business related.
- Taxpayers could elect to deduct state and local general sales taxes in lieu of the itemized deduction for state and local income taxes.
- The TCJA limits deductions for state and local taxes paid by individual taxpayers to $10,000.
- Limit does not apply to taxes are paid or accrued in carrying on a trade or business or in an activity engaged in for the production of income

Alternative Minimum Tax for Corporations and Individuals

- The Tax Cuts and Jobs Act repealed the AMT on corporations.
- The TCJA doesn't repeal the AMT for individuals, but it does increase its exemption amounts:
  - $109,400 for joint filers
  - $70,300 for single filers
- For trusts/estates, the base figure AMT exemption is unchanged.

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Changes to Tax Treatment of Alimony

- For divorces and legal separations that are executed after 2018, the alimony-paying spouse won't be able to deduct the payments, and the alimony-receiving spouse doesn't include payments in gross income.

- TCJA rules don't apply to existing divorces and separations, unless parties agree otherwise and court approves.

Changes to Deductions for Interest on Your Home Mortgage

- Limit on qualifying acquisition debt on principal residence or second home is reduced from $1 Mill. to $750,000.

- Reduced limit does not apply to refinanced pre-2018 debt.

- Deduction for interest on home equity debt eliminated. This applies regardless of when the home equity debt was incurred.

Rules Eased for Bonus Depreciation, Code Sec. 179 Expensing and Regular Depreciation

- Bonus depreciation.
- Code Sec. 179 expensing.
- Other rules for real property depreciation. If placed in service after 2017, qualified improvement property, in addition to no longer qualifying for bonus depreciation and being newly eligible as section 179 property, has a 15-year depreciation period.
- The TCJA triples the annual dollar caps on depreciation (and Code Sec. 179 expensing) of passenger automobiles and small vans/trucks.
- Computer or peripheral equipment placed in service after 2017 isn't treated as "listed property."
- The TCJA shortens the depreciation period for most farming equipment and machinery.

Rules Governing Choice of Accounting Methods by Taxpayers

- In certain situations, the TCJA raises the gross receipts limit used to determine which taxpayers can use the cash method of accounting.
- The TCJA requires (or allows) taxpayers in certain circumstances to recognize income for tax purposes no later than the year in which it's recognized for financial reporting purposes.
- These changes may have an impact on your choice of accounting method, and cause you to want you to review and, possibly, revise those choices.

Tax Benefits for Investments in Qualified Opportunity Funds

- The TCJA introduces two elections:
  - One to defer gain from the sale of property that is reinvested in 180 days in an investment in a Qualified Opportunity (QO) Fund, and
  - One to permanently exclude gain from the sale or exchange of the investment in the QO Fund if held for at least 10 years.
- Designation of a QO Zone (low-income communities) by state's chief executive officer.
- QO Fund - investment vehicle organized as a corporation or a partnership for the purpose of investing in a QO Zone.

Business Credit Changes

- New 12.5% to 25% employer credit for wages equal to at least 50% of normal wages paid to employees on family and medical leave, if employer has proper policies in place.

- 10% credit for expenditures for qualified rehabilitation buildings placed in service before 1936 eliminated.

- 20% credit for expenditures for certified historic structures must be taken ratably over five years.

Itemized Deductions for Casualty and Theft Losses

- The TCJA enacts severe new limits on individuals' itemized deductions of casualty and theft losses.

- Severe cutback. For tax years 2018 through 2025, the personal casualty and theft loss deduction isn't available, except for casualty losses incurred in a federally declared disaster.

Child Tax Credit and New Credit for Other Dependents

- Doubles the child tax credit to $2,000 per qualifying child under 17.
- Allows a new $500 credit (per dependent) for any of your dependents who are not qualifying children under 17.
- Refundable portion increased to $1,400 per qualifying child.
- Increases AGI “phase-out” threshold from $110,000 to $400,000 for married filing jointly ($200,000 for all others).
- In order to claim the credit for a qualifying child, you must include that child's Social Security number (SSN) on your tax return.

529 Accounts Used for Elementary or Secondary School Tuition

- A 529 plan distribution is tax-free if it is used to pay "qualified higher education expenses" of the beneficiary (student).
- Before the TCJA, tuition for elementary or secondary schools wasn't a "qualified higher education expense."
- The TCJA provides that qualified higher education expenses now include expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school.
- $10,000 limit on amount of tax-free distribution from a 529 plan for these newly qualified expenses.

New ABLE Account Advantages

- An ABLE account is a savings vehicle established for a designated disabled or blind beneficiary that does not affect benefit eligibility and grows tax-free if used for disability expenses.

- The TCJA makes three changes:
  - Additional ABLE contributions allowed.
  - Saver's credit allowed for designated beneficiary's ABLE contributions.
  - Tax-free rollovers from 529 accounts to ABLE accounts.

Retirement Plan Changes

- Recharacterization of IRA contributions – ROTH/Traditional.
- Rollover period for plan loan offset amounts extended to tax return due date.
- Double of limit on amount of annual length of service awards to public safety volunteers.
- Qualified 2016 and 2017 disaster distributions taxable over three-year period.
- Qualified 2016 disaster distributions not subject to 10% early withdrawal penalty.
- Three-year period to recontribute qualified 2016 and 2017 disaster distributions.

Changes Impacting Partnerships and S Corporations

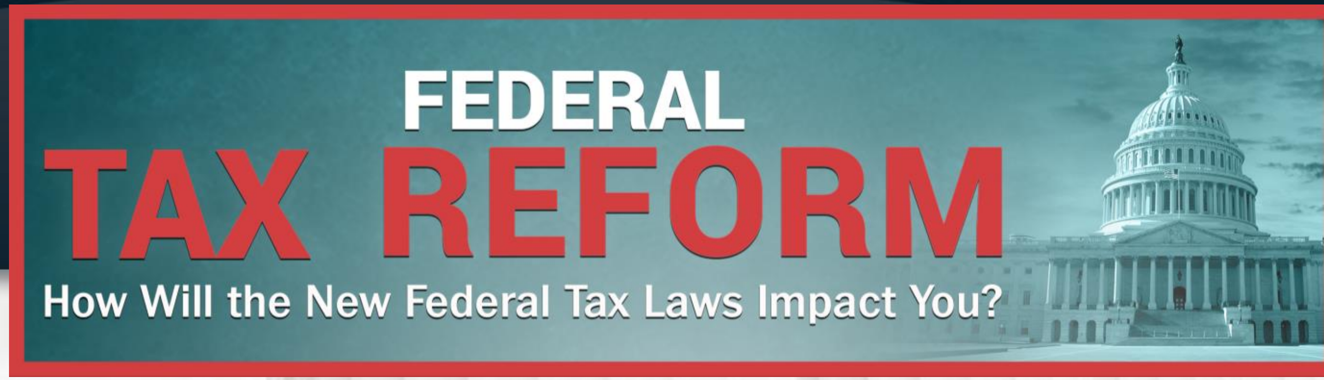
- S corporation conversion to C corporation - Section 481(a) adjustment taken into account ratably during 6-tax-year period.
- Repeal of partnership “technical termination” rule - sale or exchange of at least 50% of the partnership interest within 12 months.
- Partner’s deductible losses limited to basis in partnership interest reduced by share of partnership charitable contributions and foreign taxes paid.
- 10% withholding required on sale of partnership interest unless FIRPTA like certification provided by seller.

Impacts on Tax-Exempt Organizations

- 21% excise tax on more than $1 Mill. of compensation paid to an employee of an exempt organization.
- 1.4% excise tax on net investment income of private college with $500,000 or more of endowed assets per student.
- Exempt organization's UBTI computed separately for separate businesses.
- Exempt organization's UBTI to include disallowed fringe benefit costs.

Compensation Deductions for Excessive Employee Remuneration

- The TCJA has made changes to the tax treatment of compensation for certain highly paid employees.
- Prior to the Act, there was a cap on the deduction taken by publicly traded corporations for compensation in excess of $1 million paid to a covered employee.
- The deduction limit did not apply to commissions or performance-based compensation, such as stock options.
- Under the TCJA rules, the deduction limit includes commissions and performance-based compensation in the $1 million cap.



For more information, visit:

www.bowlesrice.com/tcja.html

Thank You!