2018 Winter Series
Tax Cuts and Jobs Act
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Topics:

1. Estates, Gifts and Trusts
2. Individual
3. Corporate and Business Law
4. Compensation and Benefits
5. Tax-Exempt Organizations
6. Application of New Law

The Tax Cuts and Jobs Act (H.R. 1) is generally effective as of January 1, 2018 and many of the tax changes are scheduled to remain in effect through 2025.

1. ESTATES, GIFTS & TRUSTS

- The federal estate and gift tax unified credit is doubled to $11,200,000 (for 2018).
- Portability remains (meaning a surviving spouse can transfer their deceased spouse's unused exclusion to the survivor via a timely filed Federal Estate Tax Return Form 706). Married couples can transfer $22,400,000 (in 2018) estate tax free under the new law. The unified credit will have inflation increases as in the past, but will remain doubled.
- Heirs continue to receive a "stepped-up, date of death" basis for inherited assets.
- Generation skipping transfer tax exemption is also doubled.
- The new law applies to the estates of decedents dying and gifts made after December 31, 2017 and before January 1, 2026. In 2026, the exemption is schedule to return to the pre-H.R.1 rates, but indexed for inflation.

2. INDIVIDUAL

- Tax Rates

2017 Tax Rates

Rate	Individual Return	Joint Return
10%	$0-$9,325	$0-$18,650
15%	$9,325-$37,950	$18,650-$75,900
25%	$37,950-$91,900	$75,900-$153,100
28%	$91,900-$191,650	$153,100-$233,350
33%	$191,650-$416,700	$233,350-$416,700
35%	$416,700-$418,400	$416,700-$470,700
39.6%	$>418,400	>$470,700

H.R. 1 Rates

Rate	Individual Return	Joint Return
10%	$0-$9,525	$0-$19,050
12%	$9,525-$38,700	$19,050-$77,400
22%	$38,700-$82,500	$77,400-$165,000
24%	$82,500-$157,500	$165,000-$315,000
32%	$157,500-$200,000	$315,000-$400,000
35%	$200,000-$500,000	$400,000-$600,000
37%	>$500,000	>$600,000

Note: Under the bill, income levels are indexed for inflation. These tax rate changes expire after 2025.

- Standard Deduction:
  - Standard deduction is nearly doubled.

Filing Status	H.R. 1	2017
Individuals	$12,000	$6,350
Heads of Household	$18,000	$9,350
Married/Filing Jointly	$24,000	$12,700

  - The enhanced standard deduction for blind and elderly remains.
  - The amount of the standard deduction will be indexed for inflation, as it has in the past.
  - It is estimated that the number of filers who itemize will be cut by more than half. Of the vast majority of married taxpayers filing jointly, only those with allowable mortgage interest, state income and local

income/property taxes and charitable deductions in excess of $24,000 would itemize.
    - Personal exemptions are eliminated.

- Mortgage Interest Deduction:
    - Mortgage interest deduction limited to interest on $750,000 acquisition indebtedness ($375,000 in case of married, filing separately) for homes purchased after December 31, 2017. If purchased before then, the current limit of $1,000,000 applies ($500,000 if married, filing separately). The deduction is not limited to the taxpayer's principal residence.
    - Interest on home equity loans is no longer deductible.

- Charitable Contributions:
    - The Act increases the AGI limitation on cash contributions from 50% to 60%, effective for contributions made in tax years 2018-2025.
    - The Act repeals the current 80% deduction for contributions made for university athletic seating rights.

- State and Local Taxes:
    - Annual itemized deductions for all state and local taxes, including property taxes, are limited to $10,000.

- Itemized Deduction Phaseout:
    - The phaseout for itemized deductions for high income earners is suspended though 2025.

- Miscellaneous Itemized Deductions:
    - All itemized deductions subject to the two percent floor are repealed. Prior examples are unreimbursed employee expenses, educator expenses under $250, tax preparation fees and other expenses paid to produce or collect income that is included in the taxpayer's gross income.

- Educator Expenses:
    - H.R. 1 increases the limit for an "above-the-line" deduction for teacher expenses by eligible educators (K-12) from $250 to $500.

- Medical Expenses:
    - The medical expense deduction is changed. The threshold for the deduction is reduced to 7.5% (down from 10%) of AGI for tax years 2017

and 2018. In other words, taxpayers with medical expenses in excess of 7.5% of their AGI may claim an itemized deduction for medical expenses.

- <u>Moving Expense Deduction:</u>
  - Moving expense deductions are generally eliminated except for active duty military who move pursuant to a military order and incident to a permanent change of station.

- <u>Child Tax Credit</u>:
  - The child tax credit is increased from $1,000 to $2,000 per qualifying child. Up to $1,400 of that credit is refundable. The AGI phaseout thresholds are also raised, starting at $400,000 (formerly $110,000) for joint filers and $200,000 (formerly $75,000) for all others.
  - There is also a $500 nonrefundable credit for qualifying dependents, other than qualifying children.

- <u>Education Credits:</u>
  - The student loan interest deduction and American Opportunity Tax Credit remain in effect.

- <u>Alimony:</u>
  - Alimony is no longer deductible to the payor or includible in income of the payee. HOWEVER, it only applies to divorce or separation judgments executed after December 31, 2018.

- <u>Retirement:</u>
  - Generally, taxation of 401(k) and other retirement plans are unchanged. The bill does repeal the ability for taxpayers to recharacterize a Roth IRA conversion as a traditional IRA contribution.

- <u>Alternative Minimum Tax (AMT):</u>
  - The AMT is retained with some modifications. The exemption amount is increased to $109,400 for joint filers, $70,300 for single taxpayers and $54,700 for married/filing separately.
  - The phase-out of exemption amounts increases to $208,400 for joint filers, $156,300 for single taxpayers and $104,200 for married/filing separately.
  - These figures will be indexed for inflation.

- Affordable Care Act:
  - The individual shared responsibility requirement under the ACA is $0. This is only effective for penalties assessed after 2018.

- ABLE Accounts:
  - ABLE programs are tax-favored savings programs intended to benefit disable individuals. Contributions to ABLE accounts are not deductible and generally may not exceed the annual gift exclusion amount.
  - In the past, contributions must also not exceed limit imposed on accounts under the qualified tuition program of its respective state. Income on ABLE accounts was not subject to tax.
  - The Act increases the contribution limit under certain circumstances. Once the overall limitation is reached, the designated beneficiary may contribute an additional amount, up to the lesser of the federal poverty line for a one-person household, or the individual's compensation for the tax year.
  - The Act also requires that a designated beneficiary, or person acting on their behalf, maintain adequate records to ensure that additional ABLE account contributions do not exceed those limits.

3. CORPORATE AND BUSINESS LAW

- Corporate Tax Rates:
  - The new corporate tax rate is a flat 21% beginning in tax year 2018. The law makes the new rate permanent. The prior corporate rates had been between 15% and 35%.

- Bonus Depreciation:
  - The 50% "bonus depreciation" is increased to 100% for property placed in service after September 27, 2017 and before January 1, 2023. A 20% phase down schedule would then kick in. The requirement that the original use of the qualified property must commence with the taxpayer is eliminated, thus allowing bonus depreciation to apply to used property.
  - For property placed in service between:
    - September 27, 2017 and December 31, 2022… 100% expensing.
    - January 1, 2023 and December 31, 2023…80% expensing.
    - January 1, 2024 and December 31, 2024…60% expensing
    - January 1, 2025 and December 31, 2025…40% expensing
    - January 1, 2026 and December 31, 2026…20% expensing

- <u>Vehicle Depreciation:</u>
  - The cap on write-offs of business-use vehicles is raised to $10,000 for the first year a vehicle is placed in service (up from current level of $3,160); $16,000 for the second year (up from $5,100), $9,600 for the third year (up from $3,050) and $5,760 for each subsequent year (up from $1,875) until costs are fully recovered. These rates apply to vehicles placed in service after December 31, 2017.

- <u>Cash Method Accounting:</u>
  - Prior to the Act, corporations and partnerships with corporate partners are prohibited from using the cash method unless they have average gross receipts of less than $5,000,000 for the prior three taxable years. The Act increases the maximum amount of gross receipts to $25,000,000, indexed for inflation.

- <u>Interest Deductions:</u>
  - Net interest expenses are generally capped at 30% of adjusted taxable income. Some exceptions apply, including for businesses with average gross receipts of $25,000,000 or less.

- <u>Pass-Through Businesses:</u>
  - Owners of partnerships, s-corporations and sole proprietors ("pass through entities") currently pay tax at the individual rates, with the highest being 39.6%. The new law allows a deduction of 20% of qualified income of pass-through entities. However, the deduction is generally limited to the greater of either: (a) 50% of W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property.

- <u>Net Operating Losses:</u>
  - The rules for NOLs are changed. Generally, NOLs would be limited to 80% of taxable income for losses arising in tax years after 2017. Carrybacks are not allowed in most cases, but carryforwards are allowed indefinitely, subject to some limitation.

- Like Kind Exchanges of Real Property:
    - The Act limits the non-recognition of gain on a §1031 exchange to real property that is not held primarily for sale.

4. **COMPENSATION & BENEFITS**

- Rollovers of Plan Loan Offsets:
    - An employee who has taken a loan against a retirement plan has until the due date for filing the employee's tax return for that year to contribute the loan balance to an IRA (prior law was 60 days) to avoid having the loan amount treated as a taxable distribution. This rule applies to employees whose plans terminate or who experience a severance from employment while having a plan loan outstanding.

- Deduction for Excessive Employee Remuneration:
    - Generally, publicly trade companies are limited to deducting compensation paid to a "covered employee" at $1,000,000 per year. Covered employees include the CEO, CFO and 3 highest paid employees. Once qualified as a covered employee, that individual remains a covered employee so long as they receive compensation from the corporation. H.R. 1 repeals the $1,000,000 limit on deductibility of compensation.

5. **TAX-EXEMPT ORGANIZATIONS**

- Unrelated Business Taxable Income:
    - In the past, the amount used to provide certain fringe benefits (such as transportation benefits, qualified parking benefits and access to on-site athletic facilities) to an exempt organization employee are not treated as unrelated business taxable income. The new Act requires exempt organizations to include those fringe benefits in unrelated business taxable income. The Act also requires organizations that carry on more than one unrelated trade or business to separately calculated unrelated business income for each trade or business, effectively preventing deduction from one to be used to offset income of another.

- Exise Tax on Tax-Exempt Organization Executive Compensation:
    - The Act imposes an exise tax equal to the corporation rate (21%) on compensation in excess of $1,000,000 paid to an applicable tax-exempt organization's five highest paid employees for a tax year.

6. **APPLICATION OF NEW LAW**

- Single filer with $50,000 in annual adjusted gross income
  - Under prior law, a single filer is entitled to $6,500 standard deduction and person exemption of $4,150, which would leave him with taxable income of $39,350. This would result in tax of $5,491 for the year.
  - Under H.R. 1, a single filer has a $12,000 standard deduction, but no personal exemption, which would result in taxable income of $38,000. This would result in tax of $4,370 under new tax brackets.
- Married couple with $100,000 AGI, no children, $7,000 annual mortgage interest, $4,000 in charitable contributions and $3,000 in other itemized deductions.
  - Under prior law, their taxable income would be reduced to $77,000 ($100,000 - $14,000 itemized deduction - $4,150 personal exemption (x2) = $77,700). This would result in tax of $10,676 for the year.
  - Under H.R. 1, the higher standard deduction makes it no longer worth itemizing, so they have taxable income of $76,000. With the new tax brackets, their tax for the year is $8,739.
- Married couple with $110,000 in AGI, three children and itemized deductions of $10,000 mortgage interest, $4,000 in charitable contributions and $7,000 in state and local property and income taxes.
  - Under prior law, this family would have $21,000 in itemized deductions and $20,750 in personal exemptions, which would result in taxable income of $68,250. This means tax for the year of $9,825. However, they get a $1,000 credit for each child, thus reducing their tax to $6,825.
  - Under H.R. 1, the family would have $24,000 standard deduction, resulting in taxable income of $86,000. This results in tax for the year of $10,799. However, the child tax credit is doubled to $2,000 per child, so their tax is lowered by $6,000 to $4,799.
- Married couple with $400,000 AGI, $10,000 in mortgage interest, $5,000 in charitable deductions, $20,000 in real estate taxes and $25,000 in state and local taxes.

  - Under prior law, the family would have $65,000 in itemized deductions and $8,300 in personal exemptions, resulting in taxable income of $326,700 and tax of $83,029.

  - Under H.R. 1, the family would be able to itemize since their deductions are larger than the standard deduction of $24,000 ($10,000 mortgage interest, $5,000 charitable deductions, $10,000 state and local taxes), resulting in taxable income of $375,000 and tax of $83,379.

- An elderly married couple with assets valued at $30 million, who both die in 2018.
  - Under prior law, the first $11,200,000 would be excluded from tax and the remainder would be taxed at 40%, translating to $7,520,000 in estate tax.

  - Under H.R. 1, the exclusion is doubled so that $22,400,000 is exempt, resulting in estate tax of $3,040,000, a savings of $4,480,000.

Sources:

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