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Tax Reform – Summary Highlights

2017.12.22

Sources:
Keebler Tax and Wealth Education, Inc.; Keeber & Associates, LLP Tax Reform – The Final Edition 12.21.17
LISI
www.Investopedia.com

Year-End Planning

Top Ten Ideas

1. Accelerate itemized deductions
2. Timing the sale of securities
3. AMT planning
4. Alimony agreements
5. Roth IRA conversions and recharacterizations
6. Estate and gift tax planning
7. Timing business expenses
8. Business taxation
9. S v. C Corporation
10. Non-grantor intentionally defective trusts

Notable Individual Changes

	Senate
Individual Rates	Overall rate decrease; 7 brackets retained
Standard Deduction	$24,000 (MFJ)
Personal Exemptions	Repealed
Child/Family Credit	Increased
AMT	Exemption increased; Exemption phaseout threshold substantially increased
SALT Deduction	Limited to $10,000 in property and state/local income taxes (except for taxes incurred in a trade or business)
Mortgage Interest Deduction	Limited to interest on up to $750,000 of acquisition indebtedness; Repeals deduction for home equity indebtedness
Pease Limitation	Repealed

Individual provisions sunset December 31, 2025

Comparison of MFJ Rates:

Income Range	Scheduled 2018 rate	TCJA
$1 to $19,050	10%	10%
$19,051 to $77,400	15%	12%
$77,401 to $156,150	25%	22%
$156,150 to $165,000	28%	22%
$165,001 to $237,950	28%	24%
$237,951 to $315,000	**33%**	**24%**
$315,001 to $400,000	33%	32%
$400,001 to $424,950	**33%**	**35%**
$424,950 to $480,050	35%	35%
$480,051 to $600,000	39.6%	35%
Over $600,000	39.6%	37%

Critical Changes

- **Estate & GST tax**
  - Doubles the exemption to $11,200,000 in 2018 (Senate & House)
  - Sunsets December 31, 2025
  - Step-up in basis retained at death
- **Business**
  - Lowers the corporate rate to 21%
  - Lowers tax liability for certain pass-through business income
  - Increased expensing of capital items
  - Business interest deduction limited
  - Active business losses limited
  - NOL deduction modified
  - Like-kind exchanges limited to real property
  - New markets tax credit retained and “opportunity zones” added
  - 20% historic rehabilitation credit now claimed over five-years and 10% pre-1936 building rehabilitation credit is repealed

Source:
Keebler Tax and Wealth Education, Inc.; Keeber & Associates, LLP Tax Reform – The Final Edition 12.21.17

Healthcare Mandate

The bill would end the individual mandate, a provision of the Affordable Care Act or "Obamacare" that provides tax penalties for individuals who do not obtain health insurance coverage, in 2019. (While the mandate would technically remain in place, the penalty would fall to $0.) According to the Congressional Budget Office (CBO), repealing the measure would reduce federal deficits by around $338 billion from 2018 to 2027, but lead 13 million more people to lack insurance at the end of that period and push premiums up by an average of around 10%. Unlike other individual tax changes, the repeal would not be reversed in 2025.

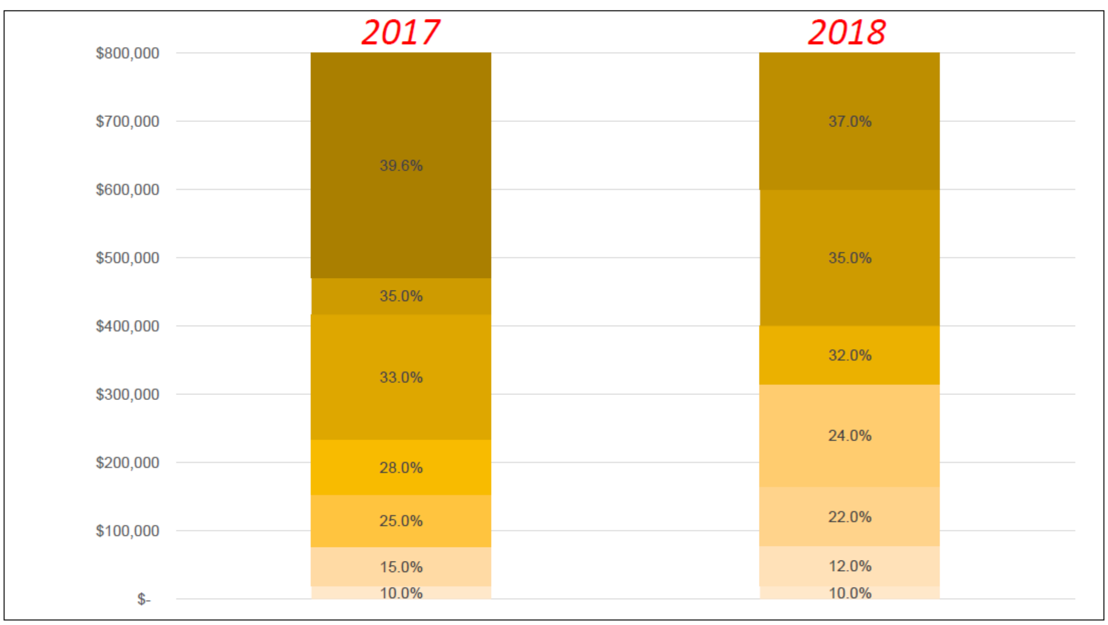
Source:
www.investopedia.com

<u>Not Included</u> in the Bill:

- Repeal of the 3.8% Net Investment Income Tax (Affordable Care Act)

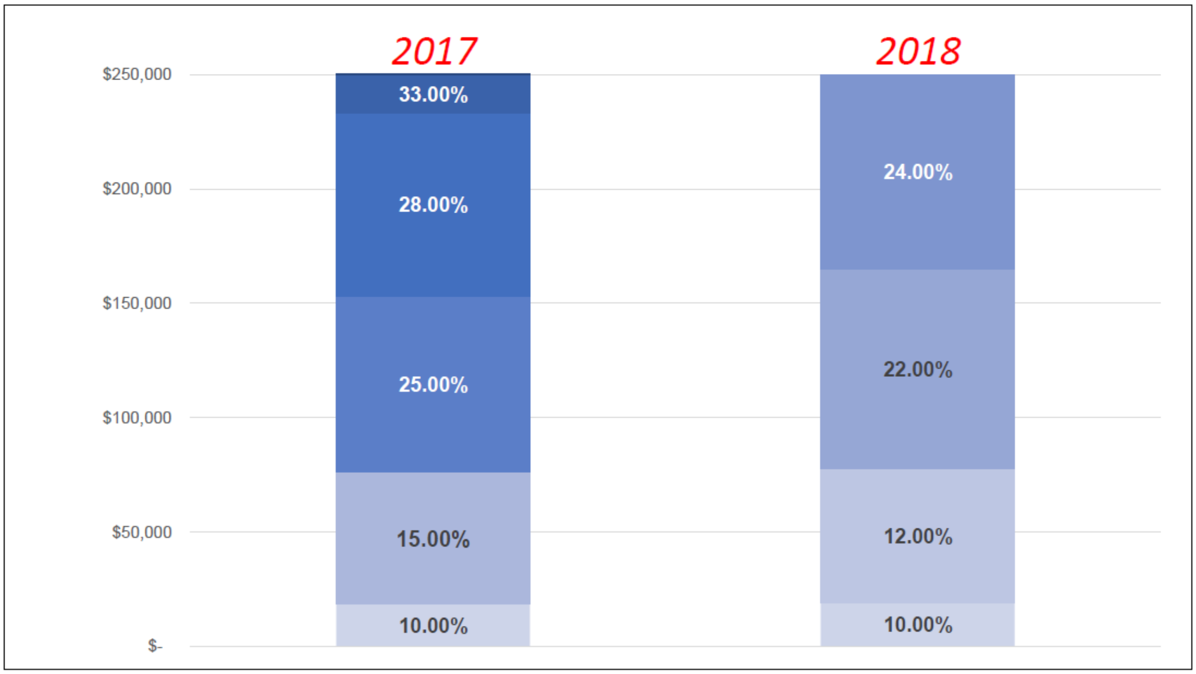
Individual Income Tax Rates

Comparison



Individual Income Tax Rates

Comparison - $250,000 & Lower



Standard Deduction

2017

CURRENT STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 6,350	$ 12,700	$ 6,350	$ 9,350

2018

STANDARD DEDUCTION

S	MFJ/QW	MFS	HOH
$ 12,000	$ 24,000	$ 12,000	$ 18,000

§ 63, §11021

Exemptions

- **Exemptions are completely repealed at the end of 2017**
  - Consolidated into the standard deduction
  - Expanded child tax credit and a new family tax credit designed to offset the loss for families

§ 151, §11041

Child and Family Tax Credits

- Credits after 2017
  - Child tax credit increased from $1,000 to $2,000
  - Compare to the value of an exemption: 12% x $4,150 = $498
  - Additional $500 nonrefundable credit for non-child dependents
- Phase-out increased after 2017
  - Phase-out to increase from $110,000 to $400,000 for joint filers
  - Compare to the value of an exemption: 32% x $4,150 = $1,328

§ 24, §11022

Child and Family Tax Credits

Summary

	2017	2018
Credit for Children	$1,000	$2,000
Credit for other Family Members	$0	$500
Phase-out Begins	$110,000	$400,000
Refundable Amount (credit for children only)	$1,000	$1,400

All figures for MFJ

§ 24, §11022

Simplification of Deductions

	2018
SALT Deduction (§ 164, § 11042)	Limited to $10,000
Mortgage Interest Deduction (§ 163, § 11043)	Limited to interest on up to $750,000 of acquisition indebtedness; Repeals deduction for home equity indebtedness
Charitable Contributions (§ 170, § 11023)	Percentage Limit increased from 50% to 60% (for cash);
Personal Casualty Losses (§71, § 11044)	Repealed, except for declared disasters
Medical Expenses (§213, § 11027)	Expanded for two years by setting the deduction threshold to 7.5% of AGI for all taxpayers
Job Expenses & Miscellaneous Deductions (§67, § 11045)	All deductions subject to the 2% floor repealed; Many above-the-line deductions retained
Alimony Paid (§71, § 11051)	Repealed for any divorce or separate instrument executed after **12/31/18**
Moving Expenses (§2017, § 11049)	Repealed

AMT

- **AMT exemption increased**

	2017	2018
Single or Head of Household	$54,300	$70,300
Married Filing Jointly	$84,500	$109,400
Begin of Phaseout, Single or HoH	$120,700	$156,300
Begin of Phaseout, MFJ	$160,900	$208,400

- **AMT exemption phaseout increased**
  - MFJ: $ 1,000,000
  - All Others: $ 500,000

§ 55, § 12003

AMT
Example

- As of 1/1/2018, James has a $300,000 AMT credit carryover

- In 2018, James had the following tax liabilities under current tax law and the 2017 tax bill:
  - 2018 regular tax (current law) - $350,000
  - 2018 AMT (current law) - $400,000
  - 2018 regular tax (2017 tax bill) - $300,000
  - 2018 AMT (2017 tax bill) - $250,000

- Under current law, $0 of the $300,000 AMT credit carryover would be utilized because AMT is greater than regular tax. However, under the 2017 tax bill, $50,000 of the AMT credit carryover would be utilized because AMT is less than regular tax (as a result of the higher AMT exemption and AMT exemption phase-out amounts)

§ 55, § 12003

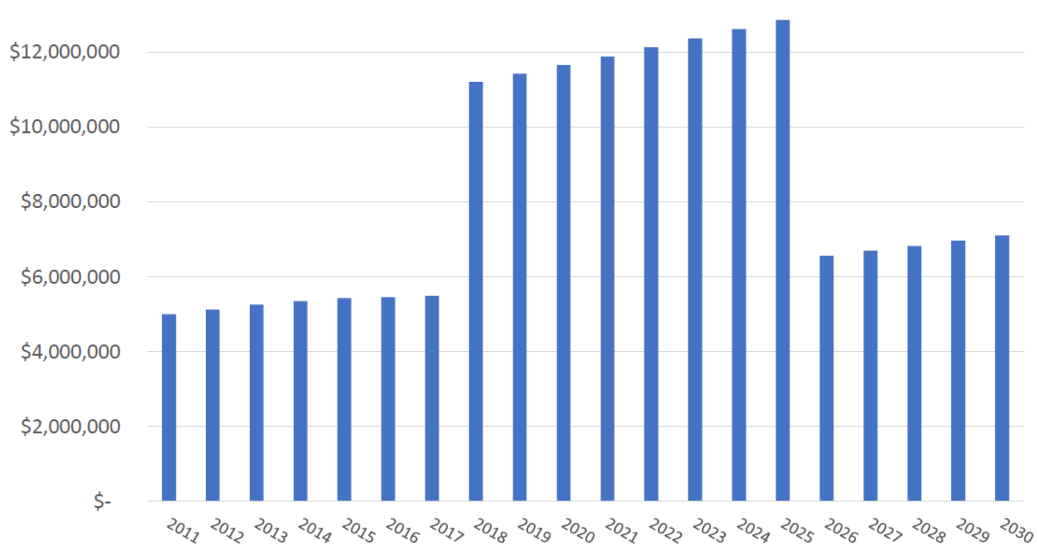
Estate & GST Taxes

- Doubles the Basic Exclusion Amount and GST exemption in 2018 ($10,000,000 in 2011 dollars)
- Higher exemption sunsets December 31, 2025
- Retains the § 1014(a) basis adjustment ("step-up")

§ 2010, §11061

Estate & GST Taxes

Estate Tax Exemption - Past & Projected



Estate & GST Taxes

Planning for a Future Congressional Reduction in the Exemption

- Tax-free gifts (to Dynasty Trusts) to use the higher exemption in anticipation of change
- IDGT sales
- Transfers taking advantage of valuation discounts.
- GST planning
- Shifting growth
- Four to eight-year GRATs for those "in the middle"
  - Force inclusion & obtain a "step-up" sunset in case of death
- GST grandfathered trusts/GST exempt trusts
- Portability elections
- "Springing" SLATs (i.e. SLAT with contingent GPOA provision)
- Increased ease of income shifting

Note: It will be difficult to decrease the exemption without creating inequitable results.

Tax Brackets for Trusts & Estates

Current (2017):

Taxable income over	But not over	Is taxed at
$0	$2,550	15%
$2,550	$6,000	25%
$6,000	$9,150	28%
$9,150	$12,500	33%
$12,500		39.6%

Tax Bill:

Taxable income over	But not over	Tax Bill
$0	$2,550	10%
$2,550	$9,150	24%
$9,150	$12,500	35%
$12,500		38.5%

Higher estate tax exemptions mean a closer examination on an individual basis needs to be made to determine tax efficiency of gifting (which conveys a lower cost basis) versus transferring via an estate (which includes a step up in basis).

Income Taxation

- State income taxes are no longer be deductible and trustees should focus on state tax reduction.
- NINGs will be more popular because state income taxes would no longer be deductible.
- Treasury bills, notes and bond interest are generally not subject to state income taxes and should be reviewed.
- It appears that some deductions for professional fees were limited in Conference.
- The selection of the proper year-end for a 645 estate/trust is an important issue this year.

Year-End Planning

- Bracket Management
- Reducing Income Taxation with Trust Distributions
- Limit on Miscellaneous Deductions (the 2% floor)
- Reducing State Income Taxation with Trust Situs

Shifting Income with Trust Distributions

General Tax Rules

- Income taxed to either the trust or the beneficiary
  - If income is accumulated, then the income is taxed to the trust
  - If income is distributed, then the trust receives an income tax deduction and beneficiaries report taxable income

WARNING

A lawyer or CPA should assist the executor or trustee with annual planning.

Corporate Tax Rates

Current

Taxable income:	Tax rate:
$0-$50,000	15 percent
$50,001-$75,000	25 percent
$75,001-$10,000,000	34 percent
Over $10,000,000	35 percent

2018

21% flat rate

§ 11, §13001

Business Pass-through Rate

- For those with taxable income in excess of $415,000 (MFJ) the deduction is limited to the greater of:
  - 50% of W-2 Wages
  - 25% of W-2 Wages plus 2.5% of unadjusted basis
- Unavailable to Specified Service Business owner's taxable income in excess of $415,000 (MFJ)
- Limitations phased-in from $315,000 - $415,000 (MFJ) of taxable income

§ 199A, §11011

Business Pass-through Rate

- Specified Service Business – defined in § 1202(e)(3)(A):

  "any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees"

- The final version includes new statutory language to exclude architects and engineers from the Specified Service Business definition

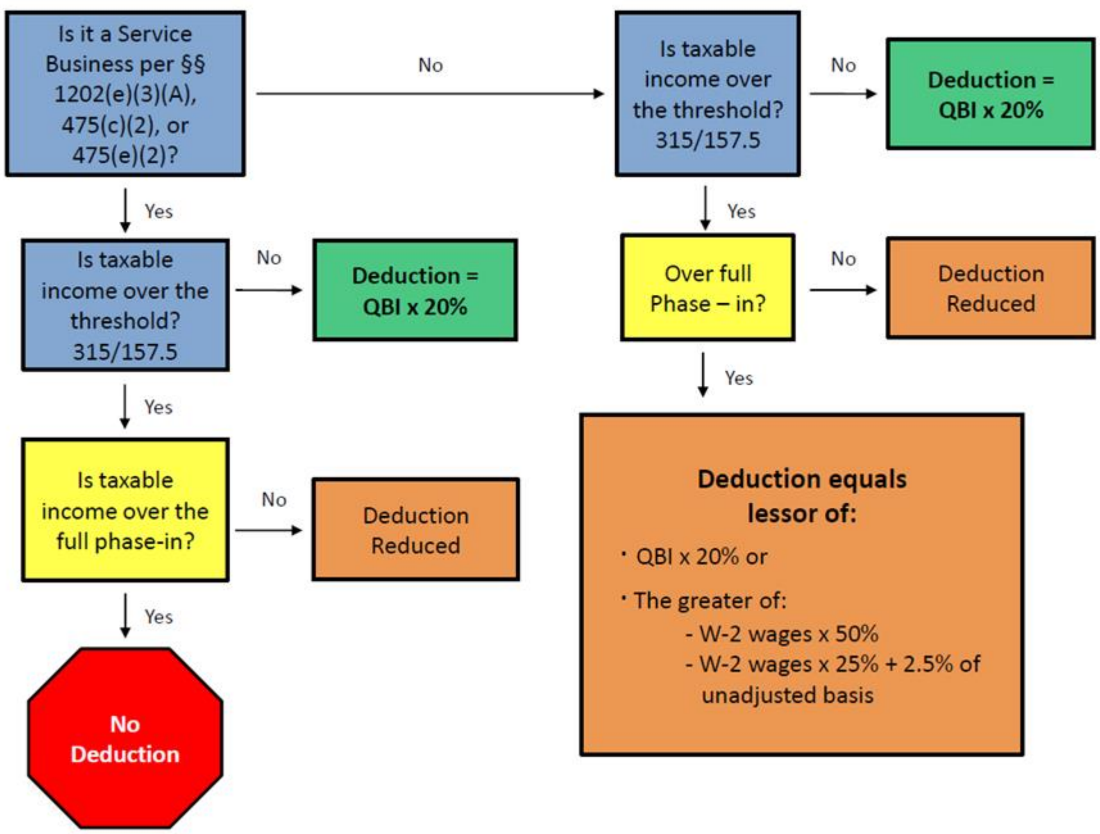
§ 199A, §11011

Business Pass-through Rate

- The deduction also cannot exceed the lessor of
  - The Combined QBI Amount, or
  - 20% x (total taxable income – capital gain)

- Combined QBI amount = deduction for each qualified trade or business ***PLUS*** 20% of REIT dividends and PTP income

§ 199A, §11011



Qualified Business Income (QBI) Deduction

Example #1

Sole Proprietor of Operating Business
(Income Below Phase-Out Range)

Taylor, married and a sole proprietor, has $100,000 net business income from her bagel shop in 2018. Taylor and her husband have $34,000 of other income and will take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Taylor's QBI deduction in 2018:

Net business income (a)	$100,000
Other income	34,000
Adjusted gross income	$134,000
Less: Standard deduction	- 24,000
Taxable income (b)	$110,000
QBI deduction*	**$20,000**

** QBI deduction = Lesser of: (a) 20% of net business income ($100,000 x 20% = $20,000) or (b) 20% of taxable income ($110,000 x 20% = $22,000)*

Qualified Business Income (QBI) Deduction

Example #2

Sole Proprietor of Operating Business
(Income Above Phase-Out Range)

Jack, married and a sole proprietor, has $1,000,000 net business income from his custom motorcycle shop in 2018. Jack and his wife have $50,000 of other income and will have $60,000 of itemized deductions ($10,000 real estate and state income taxes + $50,000 charitable donations) in 2018. Additionally, Jack's motorcycle business has $250,000 of W-2 wages and $100,000 of assets (unadjusted cost basis).

Based on these facts, below is a summary of Jack's QBI deduction in 2018:

Net business income (a)	$1,000,000
Other income	50,000
Adjusted gross income	$1,050,000
Less: Itemized deductions	- 60,000
Taxable income (b)	$990,000
QBI deduction*	**$125,000**

** QBI Deduction = Lesser of: (a) 20% of net business income ($1,000,000 x 20% = $200,000), (b) 20% of taxable income ($990,000 x 20% = $198,000) or (c) greater of: (i) 50% of W-2 wages ($250,000 x 50% = $125,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets* ([$250,000 x *25%] + [$100,000 x 2.5%] = $65,000)*

Qualified Business Income (QBI) Deduction

Example #3

S-Corporation Shareholder in a Service Business
(Income Below Phase-Out Range)

Carl, married and a 50% owner in Numbers, Inc. (a bookkeeping firm), has $200,000 of pass-through net business income in 2018. Carl and his wife have $10,000 of other income and expect to take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Carl's QBI deduction in 2018:

Net business income (a)	$200,000
Other income	10,000
Adjusted gross income	$210,000
Less: Standard deduction	- 24,000
Taxable income (b)	$186,000
QBI deduction*	**$37,200**

** QBI deduction = Lesser of: (a) 20% of net business income ($200,000 x 20% = $40,000) or (b) 20% of taxable income ($186,000 x 20% = $37,200)*

Qualified Business Income (QBI) Deduction

Example #4

S-Corporation Shareholder in a Service Business
(Income Above Phase-Out Range)

Amy, married and a 33.33% owner in Smiles, Inc. (a dental clinic), has $550,000 of pass-through net business income in 2018. Amy and her husband have $50,000 of other income and expect to take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Amy's QBI deduction in 2018:

Net business income (a)	$550,000
Other income	50,000
Adjusted gross income	$600,000
Less: Standard deduction	- 24,000
Taxable income (b)	$576,000
QBI deduction*	**$0**

** QBI deduction is completely phased out because Amy is in a service business and her income is above the phase-out range for married taxpayers*

Qualified Business Income (QBI) Deduction

Example #5

Partner in a Partnership Involved in Rental Real Estate (Income Below Phase-Out Range)

Sara, married and a 25% partner in Blackacre, LLP (a rental real estate partnership), has $250,000 of pass-through net business income in 2018. Sara and her husband have $30,000 of other income and expect to take the standard deduction ($24,000) in 2018.

Based on these facts, below is a summary of Sara's QBI deduction in 2018:

Net business income (a)	$250,000
Other income	30,000
Adjusted gross income	$280,000
Less: Standard deduction	- 24,000
Taxable income (b)	$256,000
QBI deduction*	**$50,000**

** QBI deduction = Lesser of: (a) 20% of net business income ($250,000 x 20% = $50,000) or (b) 20% of taxable income ($256,000 x 20% = $51,200)*

Qualified Business Income (QBI) Deduction

Example #6

Partner in a Partnership Involved in Rental Real Estate (Income Above Phase-Out Range)

Paul, married and a 50% partner in Greenacre, LP (a rental real estate partnership), has $750,000 of pass-through net business income in 2018. Paul and his wife have $100,000 of other income and will have $50,000 of itemized deductions ($10,000 real estate and state income taxes + $40,000 charitable donations) in 2018. Additionally, Greenacres, LP has $120,000 of W-2 wages and $4,000,000 of assets (unadjusted cost basis).

Based on these facts, below is a summary of Paul's QBI deduction in 2018:

Net business income (a)	$750,000
Other income	100,000
Adjusted gross income	$850,000
Less: Itemized deductions	- 50,000
Taxable income (b)	$800,000
QBI deduction*	**$130,000**

** QBI Deduction = Lesser of: (a) 20% of net business income ($750,000 x 20% = $150,000), (b) 20% of taxable income ($800,000 x 20% = $160,000) or (c) greater of: (i) 50% of W-2 wages ($120,000 x 50% = $60,000) or (ii) 25% of W-2 wages plus 2.5% of unadjusted cost basis of assets ([$120,000 x 25%] + [$4,000,000 x 2.5%] = $130,000)*

Cost Recovery

- Bonus Depreciation

Period	Applicable Percentage
9/27/2017 - 2022	100%
2023	80%
2024	60%
2025	40%
2026	20%

Expanded to Include Used Property
(formerly only allowed new property)

§ 168, §13201

Cost Recovery

- IRC §179 Expansion
  - Currently, a taxpayer may expense (under IRC § 179) up to $500,000 of property. However, this is phased out if a business places over $2,000,000 of property in service during the tax year
  - The proposal increases the expensing limit to $1,000,000 and the phase-out to $2,500,000

Note, Section 179 applies to new and used property

§ 179, §13101

Cost Recovery

- IRC §179 Expansion (cont.)
  - Expands the definition of qualified tangible personal property and qualified real property eligible to include
    - tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging
    - improvements to nonresidential real property placed in service after the date such property was first placed in service:
      - roofs;
      - heating, ventilation, and air-conditioning;
      - fire protection and alarm systems;
      - and security systems.

§ 179, §13101

Business Interest Deduction

- Businesses with average gross receipts that **<u>do not exceed $25,000,000</u>** are exempt (test on a affiliated basis)
- The proposal would disallow interest expense in excess of 30% of a business's "adjusted taxable income"
- "Adjusted taxable income" is computed without regard to deductions allowable for depreciation, amortization, or depletion
- Any interest disallowed would be **<u>carried forward indefinitely</u>**
- Determined at the <u>tax-filer level</u> (e.g. the **<u>partnership</u>** not the partners would be subject to testing), <u>but it is determined at the consolidated return level for affiliated corporations</u>
- At the taxpayer's election, certain real property and construction businesses and farms are exempt (but must use ADS)

§ 163, §13301

Business Interest Deduction

- Example
  - John and Mary own a number of nursing homes
  - All the facilities are owned by a corporation started by Mary's great grandfather
  - Average gross receipts are about $40,000,000 and "adjusted taxable income" is about $5,000,000
  - The business has enormous capital requirements and pays over $2,000,000 of interest annually
  - The legislation limits the deductible amount to $1,500,000 ($5,000,000 x 30%)
  - The excess can be carried forward

§ 163, §13301

NOL Deduction

- Under current law, NOLs can generally be carried forward twenty years and back two
- The legislation limits a NOL carryover deduction to offset 80% of taxable income (90% deduction for AMT)
- The legislation would also eliminate carrybacks (generally)
- NOLs to be carried forward indefinitely

§ 172, §13302

Self-Created Property

- Any patent, invention, secret formula or process, model or design
- Not a capital asset, generally
- Section 1235
  - Override provision allows qualified holder capital asset treatment
  - Individual whose efforts created the patent
  - Other individual who acquired property prior to actual reduction to practice of the invention covered by the patent if not the employer

§§ 1221,1231, §13314

Source:
Keebler Tax and Wealth Education, Inc.; Keeber & Associates, LLP Tax Reform – The Final Edition 12.21.17