MA UNIVERSITY

Estate Planning Council of SW Washington

General Overview of Tax Cuts and Jobs Act
Tuesday, January 16, 2018

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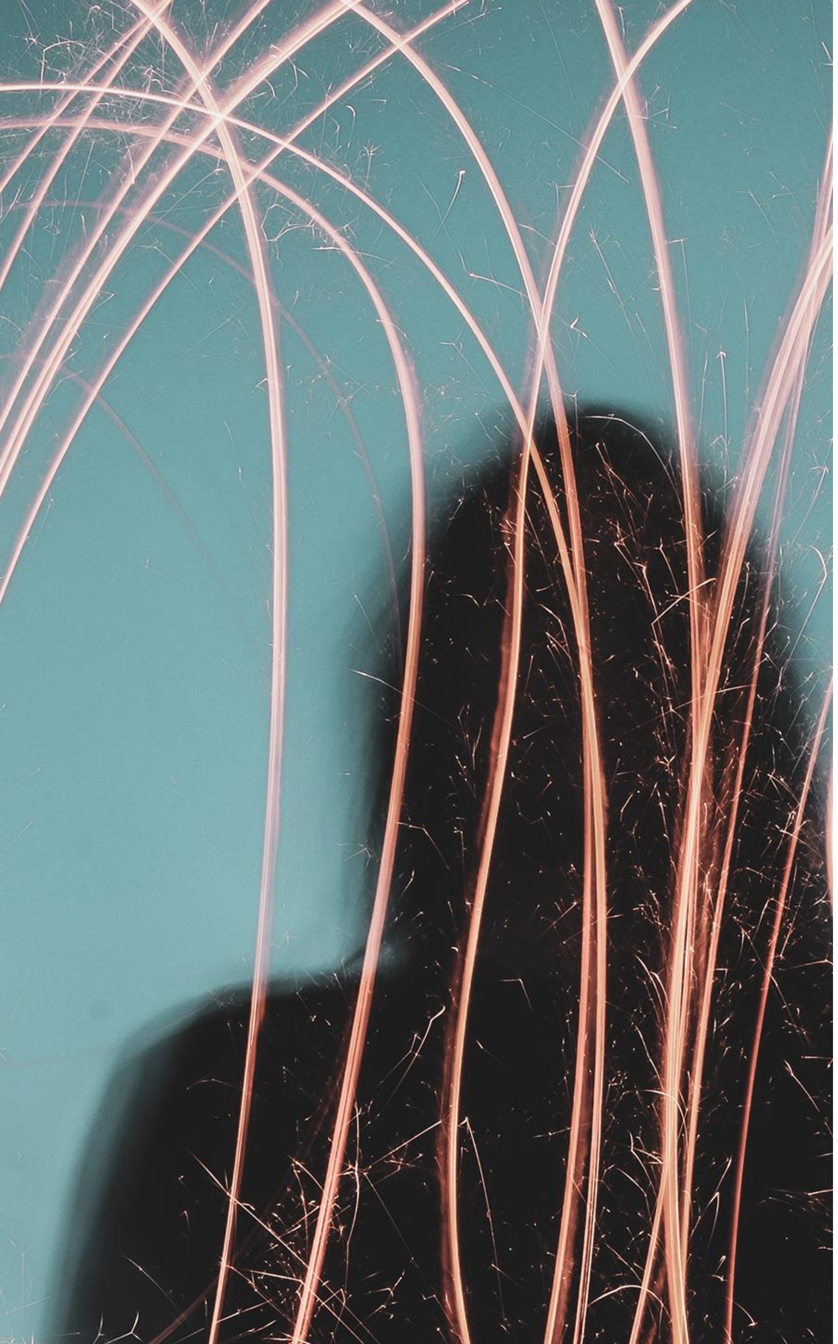

Agenda

- *Where we are today?*
- *Estate, Gift and Trusts*
- *Individual Provisions*
- *Business Provisions*

Background

H.R. 1 – Tax Cuts and Jobs Act

- *Nov 2 – Legislative text first released*
- *Nov 9 – Approved by House Ways & Means Committee*
- *Nov 16 – Bill passes House on 227-203 vote*

Senate – Tax Cuts and Jobs Act

- *Nov 9 – "Conceptual mark" released*
- *Nov 16 – Approved by Senate Finance Committee*
- *Nov 21 – Legislative text released*
- *Dec 1 – Bill passes Senate on 51-49 vote under budget reconciliation procedures*

Conference Agreement – Tax Cuts and Jobs Act

- *Dec 15 – Final House-Senate legislation released*
- *Dec 22 – President Signs bill into law*

Estate, Gift and Trust Provisions

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Income Brackets & Tax Rates

TRUSTS AND ESTATES

2017

Taxable Income Over	But not over	Tax Rate
$0	$2,550	15%
$2,550	$6,000	25%
$6,000	$9,150	28%
$9,150	$12,500	33%
$12,500		39.6%

2018

Taxable Income Over	But not over	Tax Rate
$0	$2,550	10%
$2,550	$9,150	24%
$9,150	$12,500	35%
$12,500		37%

Changes to Estate Tax

Basic Exclusion

- 2017 - $5 million per person + inflation adjustment
- 2018 - 2025 - $10 million per person plus TBD inflation adjustment.
- GST exclusion has also been increased to $10 million per person plus inflation adjustment
- Increased exemptions sunset on December 31, 2025 then go back to $5 million starting January 1, 2026

Estate Tax Provisions Not Changed

- Step-up in basis under IRC 1014(a)
- Portability Election

Estate & Tax Income Planning

Estate Year-End

- Date of death vs. other
- 2017 vs. 2018 tax law – End of reporting period
- IRC 645 election

Trustees may focus on state tax exempt income

- Muni bonds, Treasury bills and other state exempt income

Tax Planning with Distributions

- Tax at trust level or pass out to beneficiary 65-day rule

Individual Provisions

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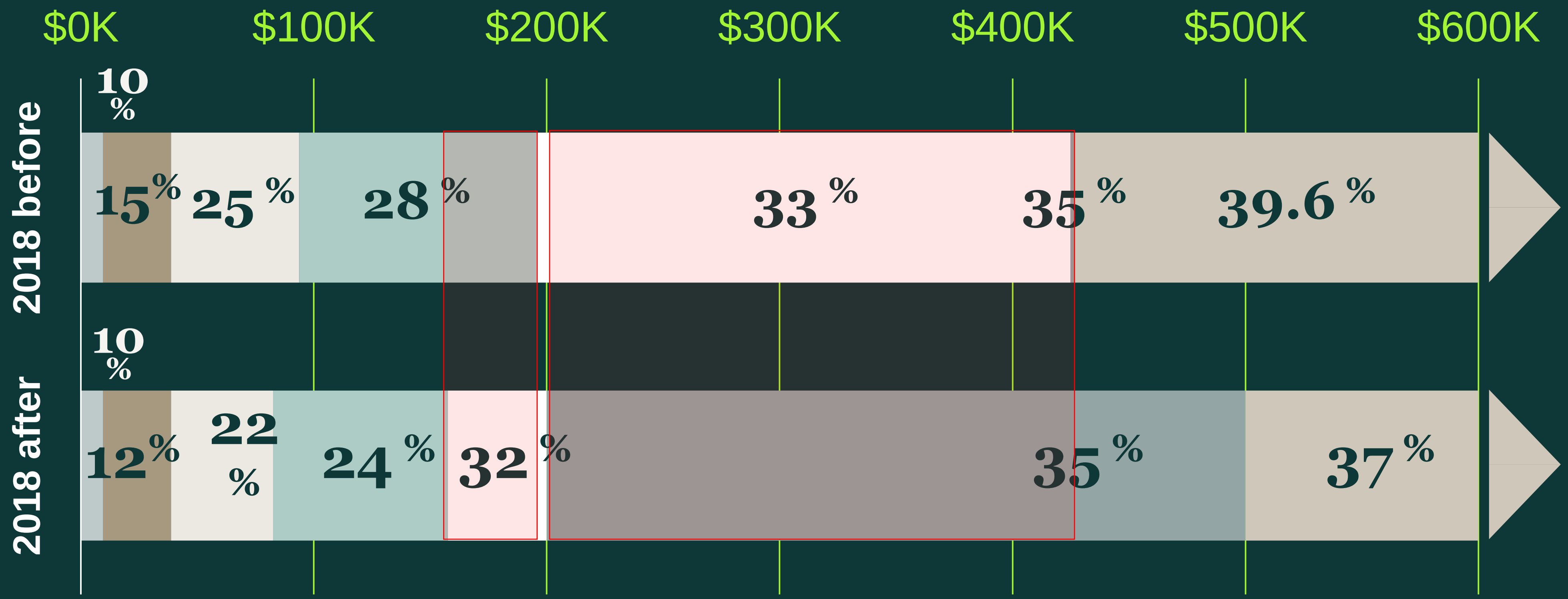
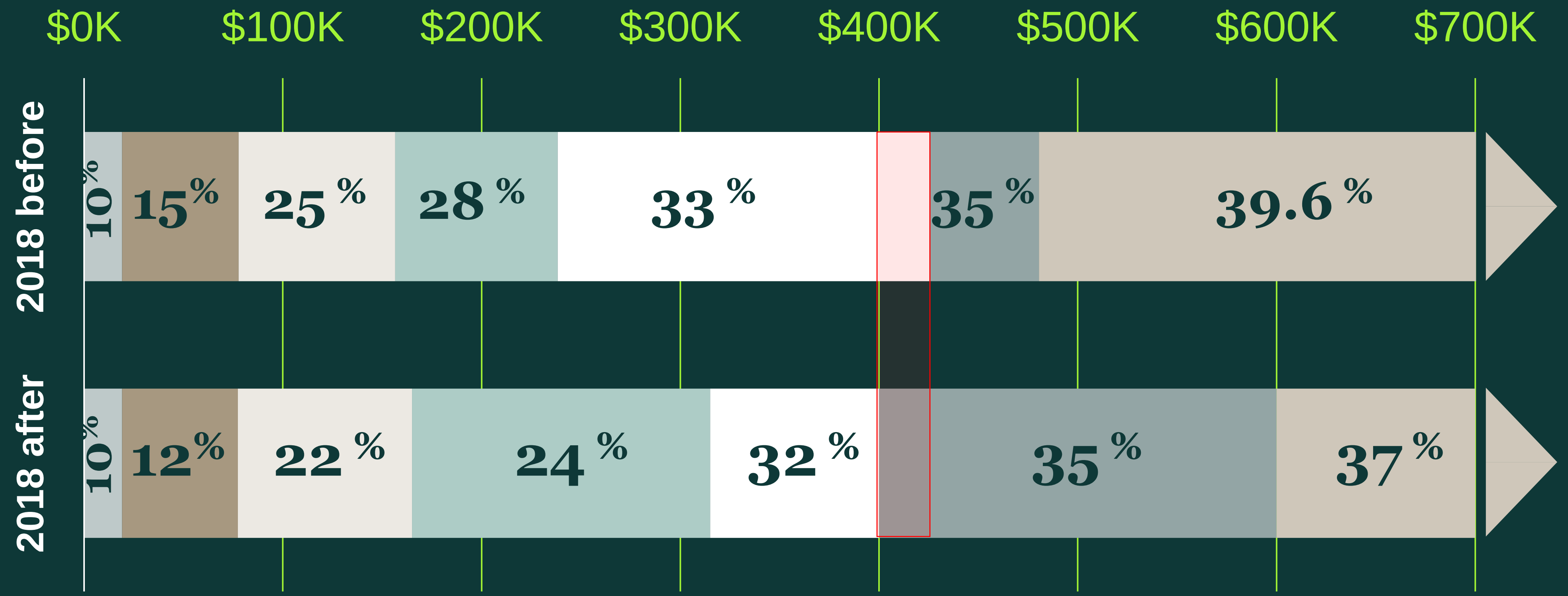
Income Brackets & Tax Rates

INDIVIDUAL FILER



Income Brackets & Tax Rates

MARRIED, FILING JOINTLY AND SURVIVING SPOUSES



Standard Deduction

Standard Deduction – Raised until 2026

Filing	2018 before	2018 after	Differenc e
Single	$6,500	$12,000	$5,500
MFJ/QW	$13,000	$24,000	$11,000
MFS	$6,500	$9,350	$2,850
HOH	$9,550	$18,000	$8,450

Exemptions

Exemptions:

- Reduced from $4,150 per person (2018) to $0
- Replaced with increased child credits
- Temporary (2025 final year)

Child Credit

Child Credit:

- $2,000 credit per dependent under 17
  - $1,400 is refundable, $600 is nonrefundable
  - Increase from $1,000
- $500 credit per qualifying dependents 17 or older
  - Nonrefundable
- Temporary (2025 final year)

Educational Provisions:

Changes:

- Elimination of tuition & fees deduction (Page 1 & Sch A)
- Adds death or disability to student loan discharge exclusion
- 529
  - Now distributions up to $10,000 may be used for elementary through high school per-student
  - Prior benefits continue

No change:

- American Opportunity & Lifetime Learning Credit

Retirement & Investment Strategies:

- Roth conversion less favorable for certain taxpayers
- Investments will need to be reanalyzed for estate & income tax impact:
  - 199A deduction
  - Income tax rates decreasing
  - Deductions limited
  - Estate exemption doubling
  - Etc. . . .
- Charitable planning

What Deductions Changed?

- State & Local Taxes
- Mortgage Interest
- Charitable Contributions
- Personal Casualty Losses
- Medical Expenses
- Job Expenses
- Miscellaneous Deductions

Charitable Contributions

Deduction	2017	2018
Charitable Contributions (§170, §11023)	Limited to 50% (Cash)	Limited to 60% (Cash)
• No discussion of Carryovers (previously 5 years) • Repeal of 80% charitable deduction for college athletic event seating rights. • No Adjustment for inflation on mileage STRATEGY NOTE: Taxpayer's may consider accumulating charitable contribution deductions into one tax year to maximize benefit. While the charitable deduction limit is increased, other changes (like lower tax rate and higher standard deduction will indirectly impact charitable giving.		

Other Deductions

Deduction	2017	2018
Personal Casualty Losses (§165, §71, §11044)	Deduction allowed for loss sustained during the taxable year not compensated by insurance if they exceed $100 per casualty or theft or in aggregate only to the extent they exceed 10% of AGI.	Repealed except for Declared Disasters until end of 2025.
Medical Expenses (§213, §11027)	Deduction threshold to extent expenses exceed 10% of AGI for most Taxpayers, 7.5% for over 65 years.	Expanded for two years (2017 & 2018) by setting deduction Threshold to 7.5% of AGI for all Taxpayers
Job Expenses & Miscellaneous Deductions (§67, §62, §212, §11045)	Deduction allowed for amounts in excess of 2% of AGI	Repealed until end of 2025

Miscellaneous Deductions Subject to the 2% Floor

- Expenses for the production or collection of income (not a complete list):
  - Investment fees and expenses
  - Hobby expenses
  - Appraisal Fees
  - Casualty and theft losses as an employee
  - Safe Deposit Boxes
  - Indirect Misc. deductions from pass-throughs
  - Trustee fees
- Tax Preparation Fees
- Unreimbursed Employee Expenses
  - Home office Deduction
  - Educator Expenses
  - Union Dues

Other Deduction Changes

Deduction	2017	2018
PEASE limitation (Overall Limitation on Itemized Deductions	Itemized deductions are phased out for high-income Taxpayers.	Suspends limit on itemized deductions until end of 2025.
Gambling/Wagering Losses	Deductible to extent of winnings. Some related expenses, such as travel are deductible without regard to winnings.	All expenses and losses associated with gambling income are only deductible to extent of winnings.

AMT

-AMT Exemption Increased

Filing Status	2017	2018
Single or HOH	$54,300	$70,300
Married Filing Joint	$84,500	$109,400
Begin Phase out – Single or HOH	$120,700	$500,000
Begin Phase out - MFJ	$160,900	$1,000,000

Business Provisions

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Summary of Corporate Changes

Provision	Pre-TCJA Law	Tax Cuts and Jobs Act
Corporate income tax	35% top rate	21% flat rate, effective tax years after 12/31/17
Corporate AMT	20% on Alternative Minimum Taxable income	Repealed
Net operating loss	2- year carryback and 20-year carryforward allowed to offset taxable income	NOL may be carried forward indefinitely, however, only 80% of taxable income in future years may be reduced by the NOL. Note that carryback period of 2 years has been repealed.

Corporate Changes – Corporate Tax Rate

- Effective for years beginning after 12/31/17, corporate tax rate is permanently changed to a flat rate of 21%.
- Personal Service Corporations "PSC" – no special rate and is taxed the same as any "C" corporation.
- Fiscal Year Taxpayers – Use a blended rate to compute tax. §15(a)

Corporate Changes – Corporate AMT

- Corporate AMT has been repealed
  - During transition period, existing AMT credits are refundable
  - Taxable years starting in 2018-2020, AMT credits can offset regular tax liability
  - 50% of the excess of the remaining minimum tax credits over the allowable credit is refundable

Corporate Changes – NOL

- New law impacting net operating loss changes is effective for years beginning after December 31, 2017.
- Existing NOLs generated prior to January 1, 2018 will continue to have a 20 year carry forward and can offset 100% of regular taxable income.
- Companies need to track carryforward in separate buckets
- Note that Sec. 382 limitations will continue to apply where applicable.
- There are special rules for life insurance, casualty/property and farming businesses.

Pass-Through Changes – Qualified Business Income Deduction

- One of the most significant changes of the new tax law for pass-through businesses is the new Section 199A deduction.

- Section 199A provides a deduction equal to the lesser of:20% of certain domestic qualifying income known as qualified business income ("QBI") or

    - 20% of the excess of the taxpayer's taxable income determined before applying Sec.199A over the taxpayer's net capital gain and cooperative dividends.

    - There is also an additional QBI deduction for 20% of qualified cooperative dividends

- The 20% QBI deduction applies to certain pass-through businesses such as sole proprietorships, S-corporations and partnerships including trusts and estates as well as dividend income from REITs.

Pass-Through Changes – Qualified Business Income Deduction

- Specific service industries, such as health, law, accounting, actuaries, performing arts, consulting, athletics, financial, brokerage and other professional services as well as traders/dealers in securities, partnership interests, or commodities cannot take the deduction unless they meet the small taxpayers exception. However, the deduction **is** available for engineering and architecture services.

- The deduction should be determined by each trade or business and is taking as a below the line deduction when computing taxable income.

- Allowed for both regular and AMT tax.

- Does not apply to tax on net investment income under Section 1411 or self-employment taxes.

- QBI deduction will expire for tax year beginning after 12/31/2025.

Pass-Through Changes – QBI Definitions

- Section 199A (c) defines QBI as:
  - The net amount of qualified items of income, gain, deduction and loss with respect to any qualified trade or business of the taxpayer.
    - Investment income such as interest income other than interest income that is properly allocable to a trade or business, dividends including payment in lieu of dividends, short-term and long-term capital gain/loss are excluded from QBI.
    - Earned income such as salaries and guaranteed payments from partnerships are also excluded.
  - Income must be effectively connected with a US trade or business.
  - Carryover of Losses
    - Net losses from qualified trades or businesses will be treated as a loss in the succeeding taxable year
- Section 199A(d) defined a qualified trade or business as any trade or business other than:
  - (a) specified service trade or business or
  - (b) the trade or business of performing services as an employee

Pass-Through Changes – QBI Limitations

- Taxpayers with qualified business income can generally take the full 20% QBI deduction from each qualified trade or business with certain limitations.
- W-2 Limitation - General Rule
  - ❖ The deduction is limited to 50% of W-2 compensation paid by the qualified trade or business during the taxable year.
  - ❖ As noted previously, the limitation does not apply to taxpayers who are below the threshold amount.
- Alternate W-2 and asset-based limitation:
  - ❖ 25% of W-2 wages plus 2.5% of unadjusted basis of all qualified property
  - ❖ Qualified property is any property used in a trade or business subject to depreciation under Section 167 and the depreciable period (or 10 years from date placed-in-service) has not ended before the end of the taxable year
  - ❖ The alternate rule provides a deduction for interests in entities that are capital intensive, but do not have significant wage expenses (e.g. real estate partnerships)
  - ❖ As the limitation is based on unadjusted basis, depreciation does not affect the amount of the deduction

Pass-Through Changes – QBI Limitations

- Small Taxpayers Exception

  - Small taxpayers, including those involved in trades or businesses specifically excluded as a qualified trade or business can still take advantage of the QBI deduction if their taxable income before Sec. 199A deduction does not exceed the following thresholds:

Filing Status	Threshold
Married Filing Jointly	$315,000
Other filers	$157,500

- Threshold amounts will be adjusted for inflation

- The deduction limitations phase-in over the next $100,000/$50,000 that the taxpayer’s income exceeds the threshold

  - The applicable percentage to determine the amount of phase-in is as follows:
    - (Excess amount)/($100k or $50K) = applicable percentage
    - The phase-in applies to all taxpayers

Pass-Through Changes – QBI Deduction Takeaway

- Section 199A is a complex provision that favors certain businesses over others.
- Taxpayers holding pass-through entities should carefully consider how the provision will apply to their particular facts.
- Taxpayers should consider the following:
  - For specified services providers, the deduction won't apply unless owner meets the small taxpayers exception. Could business be broken out between qualifying and non-qualifying activities?
  - For businesses with international operations, allocating income and expenses between U.S. and foreign operations to determine qualifying business income and maximize QBI deduction.
  - Structuring payroll among related entities in a manner that minimizes 199A wage limitations.
  - Accounting for and allocating income and deductions among qualifying and nonqualifying business activities

Pass-Through Changes – Interest Deduction Limitation

- Adjusted taxable income is computed without regard to investment income or deductions, deductions of interest, depreciation, amortization, depletion, NOLs, or the 199A deduction
  - The business interest income for the year, plus
  - 30% of the taxpayer's adjusted taxable income for the year, plus
  - The taxpayers floor plan financing interest for the year (financing of motor vehicles held for sale or lease)
- Adjusted taxable income is computed without regard to investment income or deductions, deductions of interest, depreciation, amortization, depletion, NOLs, or the 199A deduction
- Businesses with average gross receipts of $25M or less are exempted from this restriction
  - Entities considered a single employer under Sec. 52(a) or (b) (Controlled Group) or Sec. 414(m) or (o) (Affiliated Service Groups) will need to aggregate their gross receipts for purposes of this test
- Any business interest not deducted currently is treated as paid or accrued in the following taxable year. Any interest disallowed would be carried forward indefinitely.
- For pass-throughs, the limitation is determined at the entity level
- Real estate trades or businesses and farmers can elect out, but will need to use ADS lives for depreciation

Pass-Through Changes – Interest Deduction Limitation Example

Gross Revenue	$10,000,000	Interest Deduction Calculation:	
Interest Income	300,000	Adjusted Taxable Income (Gross Revenue less Operating Expenses)	$5,000,000
Gross Income	10,300,000	30% of ATI	1,500,000
Interest Expense	2,500,000	Deductible Interest (lesser of Interest Expense or 30% ATI)	1,500,000
Depreciation	2,000,000	Suspended Interest Expense (carried forward)	1,000,000
Operating Expenses	5,000,000	Taxable Income (Net Income plus suspended interest)	$1,800,000
Total Expenses	9,500,000		
Net Income	$ 800,000		

Pass-Through Changes – Excess Business Loss Provision

- Nonpassive business loss is limited

Filing Status	Current Limitation	New Limitation
MFJ	Amount of business loss	$500,000
Single	Amount of business loss	$250,000

- The limitation is applied at the taxpayer level rather than entity or business level
- The limitations will be adjusted for inflation
- The calculation is applied after determining allowable passive income/loss under Section 469
- Any disallowed loss is carried forward and treated as part of the taxpayer's net operating loss
- The provision will applies to tax years beginning after 12/31/2017 and ending before 1/1/26

Changes in Accounting Methods for Small Taxpayers

For taxpayers with average annual gross receipts for the prior three years of less than $25 Million.

- Can use cash method of accounting
- Exempt from percentage-of-completion method for long-term contracts
  - for contracts expecting to be completed within two years.
- Exempt from requirement to maintain inventories
  - Inventories can be accounted for as non-incidental materials and supplies or could follow financial accounting treatment
  - This change still requires taxpayers to track inventory and take deduction in year of sale; however, they are relieved from maintaining a formal COGS schedule.
- Exempt from UNICAP rules under Section 263A

Fringe Benefits

Provision	Current Law	Tax Cuts and Jobs Act
Entertainment Expenses	50% deductible to the extent directly related to active conduct of a trade or business.	Repealed. No deduction allowed for entertainment, amusement, or recreation.
Food and Beverage expenses for employees (in-house cafeteria or on premises)	100% deductible, if considered a fringe benefit.	50% deductible if facility meets *de minimis* requirement and for convenience of employer. **After 2025**, not deductible.
Transportation Fringe Benefits	Deductible to employer ($255/mo. Per employee).	Repeals employer's deduction, exclusion from income of employee retained.

Fringe Benefits

Provision	Current Law	Tax Cuts and Jobs Act
Moving Expenses	Business deduction and exclusion from income for recipients.	Suspends deduction and exclusion for 2018 through 2025
Employee Achievement Awards	Defined as tangible personal property which is awarded as a meaningful presentation.	Tangible personal property excludes cash, cash equivalents, gift cards, or vacation, meals, lodging, tickets to a sporting event, stocks, etc.
Bicycle Commuting Reimbursement	Exclusion from income by employee.	Repealed, no longer excludable by employee.

Other Business Tax Changes

Provision	Current Law	Tax Cuts and Jobs Act
Capital expensing	MACRS/ADS with 50% bonus depreciation phasing down in future years. Sec. 179 expensing limit of $500K.	Introduces 100% first-year expensing (until Jan. 1, 2023) on new and used property. The first-year bonus depreciation phases down and sunsets after 2026. Sec. 179 expensing limit increase to $1M.
Like-kind exchanges	Applies to both real and tangible property.	50% deductible if facility meets *de minimis* requirement and for convenience of employer. **After 2025**, not deductible.
Real property depreciation	Depreciable over a 39 year life.	Repeals employer's deduction, exclusion from income of employee retained.

S versus C Example – Conference Committee Plan

$2 M of business income; No State taxes; 1 owner

	S Corp – today	C Corp - today	S Corp - reform	C Corp – reform
Business inc.	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Less: DPAD	(180,000)	(180,000)	0	0
Less: S corp dedx	0	0	(400,000)	0
Taxable inc.	$1,820,000	$1,820,000	$1,600,000	$2,000,000
Tax	$665,951	$618,800	$531,379	$420,000
Tax rate	36.59%	34.00%	26.57%	21.00%
Tax on dividend	$0	$276,240	$0	$316,000
Tax rate overall	36.59%	44.75%	26.57%	36.80%

Questions?

THANK YOU

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