MURRAY / JONSON / WHITE & ASSOCIATES, LTD PC

Certified Public Accountants

TAX CUTS AND JOBS ACT OF 2017

INTRODUCTION

After months of intense negotiations, the President signed the ***"Tax Cuts And Jobs Act Of 2017"*** (the *"New Law"*) on December 22, 2017 - the most significant tax reform since 1986! It is no overstatement to say that this mammoth tax bill will have a significant impact on virtually every business and individual. ***Generally starting in 2018,*** the *New Law*: Reduces income tax rates for the vast majority of individual taxpayers; Substantially increases the standard deduction; Reduces or eliminates altogether certain itemized deductions; Expands or modifies certain child and dependent tax incentives; Modifies certain tax incentives for education costs; Restricts or eliminates certain employee tax-free fringe benefits; Eliminates the alternative minimum tax for corporations; Doubles the estate tax exemption; Significantly reduces the corporate tax rate; Provides for more rapid business write-offs for capital expenditures; Reduces the tax burden on owners of pass-through business entities (e.g., proprietorships, partnerships, LLCs, S corporations); and much more.

This letter highlights tax changes in the *New Law* we believe will have the greatest impact on our individual and business clients. The *New Law's* legislative text exceeds 400 pages. Consequently, this letter highlights only *selected* changes. If you have questions concerning other provisions in the *New Law* not discussed in this letter, please call our office for details. Also, ***we suggest you call our firm before implementing any tax planning technique discussed in this letter.*** You cannot properly evaluate a particular planning strategy without calculating your overall tax liability with and without that strategy. This letter contains ideas for Federal income tax planning only. ***State income tax issues are not addressed.***

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6402 Arlington Boulevard, Suite 1130, Falls Church, VA 22042-2333

Telephone 703/237-2500 Fax 703/237-3616 www.mjwcpas.com

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SELECTED TAX REFORM PROVISIONS PRIMARILY IMPACTING INDIVIDUALS

We list below selected changes under the *New Law* that we believe will have the greatest impact on individual taxpayers. ***Please note*** that each of the changes below ***impacting "individual"*** taxpayers ***will generally be first effective in 2018*** and will ***sunset after 2025*** (unless we indicate otherwise):

CHANGES IN TAX RATES, STANDARD DEDUCTION, PERSONAL EXEMPTIONS, AMT, AND CREDITS

Changes In The Individual Income Tax Rates. Your so-called "*ordinary*" income (e.g., compensation, interest income, most retirement income, and net short-term capital gains) is taxed at increasing tax rates that apply to different ranges of income depending on your filing status (single; married filing jointly, including surviving spouse; married filing separately; and head-of-household). Under prior law, there were seven *"ordinary"* income tax rates as follows: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. ***Starting in 2018,*** although the *New Law* retains seven *ordinary* income tax brackets, it changes the rates as follows: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. As compared to prior law, the *New Law's* ordinary income tax rates generally reduce the amount of income tax imposed on comparable levels of taxable income. For example, under previous law for joint filers, the tax rate that would have been applied to their taxable income from $19,050 to $77,400 would have been 15% for 2018. Under the *New Law*, that same range of taxable income for joint filers will be subject to a 12% rate for 2018. Moreover, under prior law, for 2018, the top 39.6% tax rate would have kicked in for joint filers once their taxable income exceeded $480,050 (exceeded $426,700 for singles). However, under the *New Law,* for 2018, the new top rate of 37% will not kick in for joint filers until their taxable income exceeds $600,000 (exceeds $500,000 for singles). **Observation.** Although the *New Law* lowers the actual tax rates at most income levels (regardless of filing status), determining *the overall* tax impact on a particular individual or family as compared to prior law will vary due to other changes in the *New Law,* such as: an increase in the standard deduction, loss of personal and dependency exemptions, the elimination or limitation of certain itemized deductions, increases in the child tax credit, higher income phase-outs for the child credit, a new credit for certain qualifying dependents, and others. **Planning Alert!** Although these new tax rates generally will not impact your 2017 tax return, they may likely impact the amount of taxes withheld from your 2018 wages as well as your 2018 estimated taxes. If you would like assistance in determining what tax impact the *New Law* might have on your particular situation, feel free to call us.

- **Kiddie Tax On Children's Unearned Income.** For 2017, if children below certain ages have unearned income (e.g., interest, dividends, and capital gains) above $2,100, this unearned income is generally taxed at the child's parents' tax rates. This has traditionally been referred to as the "kiddie tax." ***Starting in 2018,*** the *New Law* contains a similar but revised *"kiddie tax"* rule whereby the unearned income (above $2,100 for 2018) of the child is taxed at the higher income tax rates that apply to trusts and estates. For example, under the *New Law,* the taxable income of a trust or estate for 2018 is taxed at the highest 37% rate once the taxable income exceeds $12,500. By contrast, under the *New Law,* for 2018, the 37% rate does not apply to a single taxpayer until taxable income exceeds $500,000.

Minor Changes In The Tax Rates For Long-Term Capital Gains And Qualified Dividends. ***Starting in 2018,*** the *New Law* retains the same 0%, 15%, and 20% rates that apply for 2017 to long-term capital gains and qualified dividends. Under the *New Law,* the 0%, 15%, and 20% rates apply at income levels similar to prior law. For example, under prior law, for 2018, the 20% rate was scheduled to kick in if and to the extent a taxpayer's *long-term capital gains* and *qualified dividends* caused taxable income on a joint return to exceed $480,050. Under the *New Law* for 2018, the 20% rate applies on a joint return if and to the extent a taxpayer's *long-term capital gains* and *qualified dividends* causes the taxpayer's taxable income to equal or exceed $479,000. For a single individual, under prior law, the 20% rate was scheduled to apply for 2018 once the taxable income of a single individual exceeded $426,700. Under the *New Law*, for 2018, the 20% rate applies to a single individual once taxable income equals or exceeds $425,800. Consequently, the income levels where the 0%, 15%, and 20% long-term capital gain rates apply have changed very little as a result of the *New Law.* **Caution!** The *New Law* ***did not change*** the ***3.8% Net Investment Income Tax*** on investment income (e.g., capital gains, dividends, passive income) which will continue to apply once the modified adjusted gross income of married taxpayers filing jointly exceeds $250,000 (exceeds $200,000 if single).

Repeal Of Personal Exemption Deduction. ***Starting in 2018,*** the *New Law* repeals the personal exemption deduction for taxpayers and their dependents. Under prior law, the personal exemption amount for 2018 was

scheduled to be $4,150. **Observation.** Under prior law, to be a *"dependent"* of a taxpayer, the person had to be either the Taxpayer's *"Qualifying Child"* or *"Qualifying Relative."* Although the personal exemption deduction is repealed for dependents, the *New Law* retains the previous definitions of *"Dependent," "Qualifying Child,"* and *"Qualifying Relative,"* for other purposes, such as: Head-of-Household status; the earned income credit; and, the child credit.

Increased Standard Deduction. Several provisions in the *New Law* are intended to simplify the income tax rules for individual taxpayers. The substantial increase in the standard deduction starting in 2018 is one such provision. It is expected that far fewer people will benefit from itemizing their deductions, and therefore their record-keeping will be simplified. The *New Law* increases the *Standard Deduction* to the following levels for 2018: Joint Return - $24,000 (up from $13,000); Single - $12,000 (up from $6,500); and Head-of-Household - $18,000 (up from $9,550). As under prior law, the *New Law* provides for an *"additional"* standard deduction for taxpayers who are disabled or blind of $1,300 for joint filers ($1,600 if single). In addition, for someone who could have been claimed as a dependent of another, the *New Law* retains the standard deduction of $1,050 (or the dependent's earned income plus $350, if greater).

Enhanced Child Credit. For 2017, subject to certain income phase-out thresholds, individuals were allowed a child credit of $1,000 for each ***"Qualifying Child"*** who had not reached age 17 by the end of the tax year. ***Starting in 2018,*** the *New Law* increases the child credit for each ***"Qualifying Child"*** to $2,000. Under the *New Law*, this child credit begins phasing out as the individual's modified adjusted gross income (MAGI) exceeds the following amounts: ***Joint Return - $400,000*** (up from $110,000); ***Others - $200,000*** (up from $75,000). Also, the *New Law* allows up to $1,400 (up from $1,000) of the child credit to be *"refundable"* to the extent of 15% of the taxpayer's earned income in excess of $2,500 (down from $3,000). ***Please note that*** a ***"refundable"*** credit generally means to the extent the credit exceeds the taxes you would otherwise owe with your individual income tax return without the credit, the IRS will send you a check for the excess. Also, for purposes of the *New Law's* enhanced child credit, the term ***"Qualifying Child"*** has the same definition as under prior law (i.e., a child who meets certain residency, age, relationship, and support tests). **Observation.** Due to the doubling of the child credit ($1,000 to $2,000), the increase in the refundable portion ($1,000 to $1,400), and the substantial increases in the income phase-out threshold, this credit will be more valuable and more widely available than under prior law.

New $500 Credit. The *New Law* creates a ***new non-refundable credit of $500*** for each person the taxpayer could have claimed as a dependent under prior law but who is not a *Qualifying Child (*e.g., a **"*Qualifying Relative"***). This $500 credit is added to any other child tax credits and the total credits begin phasing out once a taxpayer's MAGI exceeds $400,000 on a joint return or $200,000 for singles.

Changes To The Alternative Minimum Tax For Individuals. Although the *New Law* ***retains*** the ***"Alternative Minimum Tax"*** (AMT) for individual taxpayers, it offers new relief: **1)** By increasing the AMT exemption amounts for joint filers to $109,400 (up from $86,200) and for single filers to $70,300 (up from $55,400), and **2)** By increasing the amount of alternative minimum taxable income where the AMT exemption amount begins to phase out for joint filers to $1 million (up from $164,100) and for single filers to $500,000 (up from $123,100). These amounts will be indexed for inflation for future years. **Observation.** Deductions for *personal exemptions, un-reimbursed employee business expenses, miscellaneous itemized deductions,* and *state and local taxes* are generally not allowed for AMT purposes. Since the *New Law* repeals the deduction for *personal exemptions, un-reimbursed employee business expenses, and* most *miscellaneous itemized deductions* altogether, and also caps the deduction for *state and local taxes* at $10,000 (as discussed in more detail below), it is expected that fewer individuals will be subject to the AMT after 2017. **Caution!** The *New Law* does retain certain adjustments that could potentially trigger AMT. For example, an individual who exercises an *incentive stock option* could possibly trigger an AMT liability even under the *New Law.*

SELECTED CHANGES TO VARIOUS TAX DEDUCTIONS FOR INDIVIDUAL TAXPAYERS

Repeal Of Certain "Above-The-Line" Deductions. Under both prior law and the *New Law*, so-called ***"above-the-line"*** deductions reduce both your "*adjusted gross income"* (AGI) and your *"modified adjusted gross income*" (MAGI), while ***"itemized"*** deductions (i.e., below-the-line deductions) do ***not*** reduce either AGI or MAGI. Deductions that reduce your AGI (or MAGI) can potentially generate multiple tax benefits by: **1)**

Reducing your taxable income and allowing you to be taxed in a lower tax bracket; **2)** Freeing up deductions (and tax credits) that phase out as your AGI (or MAGI) increases (e.g., child credit; certain IRA contributions; certain education credits; adoption credit, etc.); **3)** Reducing your MAGI below the income thresholds for the 3.8% Net Investment Income Tax (i.e., 3.8 % NIIT only applies if MAGI exceeds $250,000 if married filing jointly; $200,000 if single); or **4)** Reducing your household income to a level that allows you to qualify for a *"refundable"* Premium Tax Credit for health insurance purchased on a government Exchange.

- **"Above-The-Line" Deductions That Were Not Repealed Under The New Law.** Many of the popular ***"above-the-line"*** deductions were retained under the *New Law.* For example, the following above-the-line deductions were retained: deductions for IRA or Health Savings Account (HSA) contributions, health insurance premiums for self-employed individuals, qualified student loan interest, and business expenses for a self-employed individual. However, as discussed immediately below, several notable above-the-line deductions were repealed, such as the ***Qualified Moving Expense*** deduction and the ***Alimony*** deduction.

Repeal Of The Deduction For Qualified "Moving Expenses." Under prior law, the deduction for qualified ***"Moving Expenses"*** was an *above-the-line* deduction. ***Starting in 2018,*** the *New Law* ***repeals*** the deduction for ***"Moving Expenses"*** except for members of the Armed Forces who move pursuant to military orders. Likewise, an employer is no longer allowed to reimburse an employee's moving expenses on a tax-free basis except for these qualifying members of the Armed Forces.

Repeal Of Deduction For Qualified "Alimony Payments." Currently, an individual making qualified alimony payments is allowed an *"above-the-line"* deduction for the payments and the recipient of the payments must include the payments in income. **Effective for *"Divorce or Separation Instruments"* *executed after 2018,*** the *New Law* ***repeals altogether*** the deduction for ***alimony payments,*** and the alimony payments ***will no longer be taxable to the payee.*** If the divorce instrument is ***executed before 2019,*** but ***modified after 2018,*** the alimony payments made after the modification will continue to be deductible by the individual making the payments (and taxable to the recipient) unless the modification ***expressly provides*** that the alimony payments are to be nondeductible to the payer and nontaxable to the recipient. **Planning Alert!** Individuals contemplating divorce must ***"execute"*** a ***"Divorce or Separation Instrument"*** ***before 2019*** to ensure that any alimony payments will be deductible. Individuals who anticipate receiving alimony payments can avoid being taxed on those payments if they delay ***"executing"*** any ***"Divorce or Separation Instrument"*** until ***after 2018.***

- **Divorce Or Separation Agreement.** The term ***"Divorce or Separation Instrument"*** means: **1)** A decree of divorce or separate maintenance, or a written instrument incident to such a decree, **2)** A written separation agreement, or **3)** A decree (not described in the previous Item # 1) requiring a spouse to make payments for the support or maintenance of the other spouse.

- **Child Support.** The prior law treatment of child support is not changed by the *New Law* (i.e., child support payments are not deductible by the individual making the payments and are not taxable to the recipient).

New Limitations For And Repeal Of Certain "Itemized Deductions." ***"Itemized Deductions"*** (i.e., *below-the-line* deductions) do ***not*** reduce your AGI or MAGI, but may still provide tax savings if they exceed in the aggregate your *Standard Deduction.* Since the *New Law* substantially increases the Standard Deduction, it will take a larger amount of itemized deductions to generate a tax benefit after 2017. However, the *New Law* not only increases the amount of the Standard Deduction, it also repeals or places new limits on several popular itemized deductions. Consequently, it is anticipated that fewer individuals will *"itemize"* deductions under the *New Law*.

New Limits On The Home Mortgage Interest Deduction. For 2017, individuals are generally allowed an *itemized deduction* for home mortgage interest: **1)** Paid on up to $1,000,000 ($500,000 for married individuals filing separately) of ***"Acquisition Indebtedness"*** (i.e., Funds borrowed to purchase, construct, or substantially improve your principal or second residence and secured by that residence), and **2)** Paid on up to $100,000 of ***"Home Equity Indebtedness"*** (i.e., Funds borrowed that do not qualify as *"Acquisition Indebtedness"* but are secured by your principal or second residence - regardless of how the funds are used).

The *New Law* makes the following changes:

- **For tax years beginning after 2017,** the dollar cap is reduced ***from $1,000,000 to $750,000*** ($375,000 for married filing separately) ***for "Acquisition Indebtedness"*** **incurred *after December 15, 2017.*** The ***$1,000,000 cap remains*** for ***"Acquisition Indebtedness" incurred on or before December 15, 2017.*** The ***$750,000 cap*** for ***"Acquisition Indebtedness" incurred after December 15, 2017,*** is reduced by the balance of any grandfathered *"Acquisition Indebtedness"* incurred on or before December 15, 2017. ***For example,*** assume an individual had qualifying *"Acquisition Indebtedness"* of $900,000 on December 15, 2017 for the acquisition of the individual's principal residence. On January 31, 2018, the individual borrows $500,000 to purchase a second home and on January 31, 2018, the grandfathered *"Acquisition Indebtedness"* has a balance of $898,000. In this case, none of the interest on the $500,000 mortgage incurred to purchase the second home would be deductible while the outstanding balance of the grandfathered *Acquisition Indebtedness* exceeded $750,000. Also, under a special rule, a taxpayer who has ***entered into*** a ***binding written contract before December 15, 2017*** to close on the purchase of a ***"principal residence"*** before ***January 1, 2018,*** and who purchases that residence ***before April 1, 2018,*** is treated as having incurred the *Acquisition Indebtedness* before December 15, 2017. Therefore, interest on up to $1,000,000 ($500,000 if married filing separately) of the indebtedness would be deductible as home mortgage interest.

- **Special Rule When Refinancing Acquisition Indebtedness.** Subject to limited exceptions, the refinancing of *Acquisition Indebtedness* is generally deemed to have been incurred on the date of the original indebtedness. So, for example, if a taxpayer incurred *Acquisition Indebtedness* on or before December 15, 2017, the refinancing of that indebtedness after December 15, 2017 will still be entitled to the $1,000,000 cap (to the extent of the outstanding balance of the original *Acquisition Indebtedness* on the date of the refinancing).

- **Repeal Of Interest Deduction For "Home Equity Indebtedness."** ***For tax years beginning after 2017,*** taxpayers may not deduct interest with respect to *"Home Equity Indebtedness"* (i.e., Up to $100,000 of funds borrowed that do not qualify for *"Acquisition Indebtedness"* but are secured by your principal or second residence). Unlike the interest deduction for *"Acquisition Indebtedness,"* the *New Law* ***does not grandfather*** an interest deduction for ***"Home Equity Indebtedness"*** that was ***outstanding before 2018.***

- **Qualified Second Residence Still Allowed.** The *New Law* did not change the rule that *Acquisition Indebtedness* can be incurred with respect to your qualified *"Second Residence"* (as well as your *"principal residence"*).

New Limitation On The "State And Local" Tax Deduction. ***Starting in 2018,*** the aggregate itemized deduction for state and local real property taxes, state and local personal property taxes, and state and local income taxes (or sales taxes if elected) is ***limited to $10,000*** ($5,000 for married filing separately). Foreign real property taxes are not deductible at all. However, deductions continue to be allowed for state, local, and foreign ***"property"*** taxes, and ***"sales"*** taxes paid or incurred in carrying on the taxpayer's ***trade or business*** (e.g., taxpayer's Schedule C, Schedule E, or Schedule F operations) or in connection with the taxpayer's production of income.

Repeal Of Casualty Loss Deductions. ***Starting in 2018,*** the *New Law generally* repeals the deduction for personal casualty losses and theft losses. However, personal casualty losses attributable to a Federally-declared disaster continue to be deductible under the rules of existing law.

New Restrictions On Deductions Relating To Gambling Activities. The *New Law* continues to limit the deduction for gambling losses (i.e., wagering losses) to gambling winnings. However, ***starting in 2018,*** the *New Law* also limits ***deductions other than gambling losses related to gambling*** (e.g., travel expenses of a professional gambler and costs of wagers) ***to gambling winnings.***

Changes To The Charitable Contribution Deduction. The *New Law* retains the charitable contribution deduction with the following changes ***starting in 2018:*** **1)** The 50% AGI limitation under prior law for cash contributions to public charities and certain other organizations ***is increased to 60%,*** and **2)** A charitable

contribution deduction is no longer allowed for contributions made to colleges and universities in exchange for the contributor's right to purchase tickets or seating at an athletic event (prior law allowed the taxpayer to deduct 80% as a charitable contribution).

- **Tax-Free Qualifying Transfers From IRAs To Charities Retained.** The popular rule allowing taxpayers who ***have reached age 70½*** to make a tax-free transfer of ***up to $100,000*** from ***their IRAs directly to a qualified charity*** has been retained. The IRA transfer to the charity also counts toward the IRA owner's "*Required Minimum Distributions"* (RMDs) for the year. **Planning Alert!** Since this tax break effectively allows a qualifying taxpayer to exclude all or a portion of their otherwise taxable RMDs from taxable income, it has the same effect as allowing an *"above-the-line"* deduction for the charitable contribution. Therefore, the *New Law* makes this tax break even more valuable for those individuals who will not itemize deductions because of the increased standard deduction.

Modifications To The Deduction For Qualified Medical Expenses. The *New Law* generally retains the existing rules for medical expense deductions. However, for ***tax years beginning in 2017 and 2018,*** for both regular tax purposes and AMT purposes, a taxpayer may deduct medical expenses to the extent they ***exceed 7.5%*** (down from 10%) of his or her AGI. The 7.5% threshold reverts back to 10% ***after 2018.***

Elimination Of 3% Phase-Out Of Itemized Deductions. For 2017, most *itemized deductions began* phasing out using a 3% phase-out rate once an individual's adjusted gross income (AGI) exceeds a certain amount. For example, for 2017, the phase-out for joint filers began at $313,800 and at $261,500 for singles. ***Starting in 2018,*** the *New Law* repeals this 3% phase-out rule.

Repeal Of Miscellaneous Itemized Deductions Subject To The 2% Of AGI Reduction. For 2017, certain *"miscellaneous itemized deductions"* (e.g., un-reimbursed employee business expenses, certain investment expenses) were allowed only to the extent they exceeded in the aggregate 2% of the taxpayer's adjusted gross income (AGI). ***Starting in 2018,*** the *New Law* not only repeals this 2% reduction rule, but also ***repeals*** the deduction for *"Miscellaneous Itemized Deductions"* that were subject to the 2% of AGI reduction. Examples of the expenses that will not be deductible after 2017 include: Un-reimbursed employee business expenses; Employee home office expenses; Clerical help and office rent in managing investments; Depreciation on home computers used for managing investments; Safe deposit box rental fees; Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust; Fees to collect interest and dividends; Most hobby expenses; Indirect miscellaneous itemized deductions from pass-through entities; Investment fees and expenses; Loss on Roth IRAs or traditional IRAs that have basis (when all amounts have been distributed); Trustee's fees for an IRA (even if separately billed and paid); and, Tax preparation fees.

- **Un-Reimbursed Employee Business Expenses.** ***Un-reimbursed*** *employee business expenses* were *Miscellaneous Itemized Deductions* under prior law and, therefore, ***starting in 2018,*** are ***not deductible at all*** under the *New Law.* However, employee business expenses ***that are reimbursed under the employer's accountable reimbursement arrangement*** were not *Miscellaneous Itemized Deductions* under prior law. Thus, under both prior law and the *New Law*, if an employee ***is reimbursed*** for a ***legitimate business expense*** by his or her ***employer under an accountable reimbursement arrangement***, the ***reimbursement is deductible*** by the employer and ***is not taxable to the employee.***

  Caution! Under the *New Law,* employee business expenses ***that are not properly reimbursed by the employer*** under an accountable reimbursement arrangement ***are classified*** as ***Miscellaneous Itemized Deductions*** and, therefore, ***are not deductible after 2017.*** Examples of ***"un-reimbursed"*** employee business expenses that ***are not deductible*** under the *New Law* include: Automobile expenses including auto mileage; Costs of travel, transportation, lodging, and meals related to the employee's work; Union dues and expenses; Work clothes and uniforms; Otherwise qualifying home office expenses; Business bad debt of an employee; Business liability insurance premiums; Damages paid to a former employer for breach of an employment contract; Depreciation on an employee's computer used for employment purposes; Dues to a chamber of commerce membership for employment-related purposes; Dues to professional societies; Work-related education expenses; Job search expenses in the employee's present occupation; Licenses and regulatory fees; Malpractice insurance premiums; Research expenses of a college professor; Rural mail carriers' vehicle expenses; Subscriptions to professional journals and trade magazines related to the employee's work; and Tools and supplies used in the employee's work.

Planning Pointer! If any of these expenses are reimbursed under your employer's *accountable reimbursement arrangement,* your employer will get a ***deduction*** for the reimbursement, and ***you will not be taxed*** on the reimbursement.

- **"Miscellaneous Itemized Deductions" That Are Still Deductible.** The following *"Miscellaneous Itemized Deductions"* are ***not subject to the 2% threshold under*** prior law and, therefore, ***remain deductible*** under the *New Law*: Amortizable bond premium; estate tax on income in respect of a decedent (IRD); impairment-related work expenses; and, repayments ***of more than $3,000*** under a claim of right.

SELECTED OTHER MISCELLANEOUS CHANGES IMPACTING INDIVIDUALS

The *New Law* also made the following tax changes that impact individuals:

Recharacterization Of Roth IRA Conversions No Longer Allowed. ***Starting in 2018,*** the *New Law* ***prohibits recharacterizations*** of the conversion of a traditional IRA to a Roth IRA. Under prior law, an individual was generally allowed to recharacterize a conversion of a traditional IRA to a Roth IRA as late as October 15th of the following calendar year.

Extended Rollover Period For Plan Loan Offsets. If an employee terminates employment with an outstanding loan from an employer's retirement plan (e.g., a 401(k) plan) and does not repay the loan, the balance of the loan is usually offset against the employee's retirement account. This offset is treated as a taxable distribution from the plan. Prior to 2018, the individual could contribute cash to an IRA within 60 days of the loan offset and the amount of the unpaid loan would not be included in the individual's income to the extent of the contributed amount. ***Starting in 2018,*** the *New Law* provides that an employee who separates from employment with an outstanding loan from an employer-sponsored retirement plan has ***until the due date for filing the employee's income tax return for the year of the offset, including extensions*** (instead of the current 60 days), to contribute (i.e., rollover) any of the offset amount to an IRA and avoid taxation to the extent of the amount contributed.

Additional Contributions May Be Made To An ABLE Account. ***Starting in 2018,*** the *New Law* allows the designated beneficiary of an ABLE Account to make a contribution in excess of the normal limitation ($15,000 for 2018) equal to the ***lesser of*****: 1)** The ***Federal poverty line*** for a one-person household ($12,060 for 2017), or **2)** The designated beneficiary's compensation for the year. In addition, the designated beneficiary of the ABLE account ***may claim the saver's credit for contributions made to his or her ABLE account.*** An ***"ABLE Account"*** is a relatively new tax-favored savings account for qualified disabled beneficiaries.

Penalty For Failure To Purchase Health Care Coverage Repealed After 2018. ***Starting in 2019,*** the *New Law* essentially eliminates the penalty for failure to purchase qualified health coverage by reducing the ***"Shared Responsibility Tax"*** (SR Tax) ***to zero.*** **Planning Alert!** The *SR Tax* for failure to purchase qualified health care coverage ***continues to apply for 2017 and 2018,*** unless an exemption from the tax applies. For those without qualified health care coverage for all of 2017 or 2018 (assuming no exemption applies), the ***SR Tax*** is generally the ***greater of:*** **1)** 2½% of household income in excess of the income tax return filing threshold, or **2)** $695 per adult ($347.50 per child under age 18) limited to a household maximum of $2,085. **Planning Pointer!** If you or your dependent does not have qualifying health care coverage, you may qualify for an exemption, such as: You lived abroad and met certain conditions; You failed to have *"qualified health plan coverage"* for less than 3 months during the year; Your income is below the threshold for filing an income tax return; or, You qualify for a ***"hardship exemption."*** If you think you or your dependent may qualify for a *"hardship exemption"* in 2017 or 2018, you will generally need to apply by submitting a hardship application form to: Health Insurance Marketplace – Exemption Processing, 465 Industrial Blvd., London, KY 40741.

- **ACA's "Premium Tax Credit" Is Not Repealed.** The *New Law* ***did not repeal*** the refundable ***"Premium Tax Credit"*** under ACA for eligible low-and-middle income individuals who purchase health insurance through a State or Federal Exchange.

Repeal Of Tax-Free Bicycle Commuting Reimbursements. During 2017, employers could provide an employee a tax-free reimbursement for the purchase of a bicycle, bicycle improvements, repairs, and storage of up to $20 per month where the employee regularly traveled to work on a bicycle. ***Starting in 2018,*** the *New Law* repeals the tax-free treatment of an employee's qualified bicycle commuting reimbursement.

CHANGES IN EDUCATION TAX INCENTIVES

Changes In The Tax Incentives For Education Expenditures. Over the last 20 or so years, Congress has passed a legion of separate tax incentives related to education (e.g., American Opportunity Credit, Life-Time Learning Credit, Student Loan Interest Deduction, Section 529 Plans, etc.). Initially, the tax reform proposals introduced in 2017 recommended significant changes to the education tax incentives. However, very few of these proposed changes were included in the final legislation signed by the President. Consequently, most of the education tax breaks available for 2017 remain unchanged, except for the following:

529 Plans Allowed To Pay K-12 Tuition. Previously, tax-favored distributions from 529 plans could only be made for post-high school education expenses. ***Starting in 2018,*** the *New Law* allows 529 plans to pay ***up to $10,000 per year*** of qualified tuition in connection with the enrollment or attendance of the designated beneficiary at ***a public, private, or religious elementary or secondary school.*** **Caution!** This annual $10,000 limitation applies on a per-student basis. Thus, an individual who is a designated ***beneficiary of multiple §529 plans may receive total distributions for K-12 expenses during a taxable year of no more than $10,000.*** Any excess over this amount would be treated as a distribution subject to tax under the general distribution rules for §529 plans. **Note!** The *New Law* retains the existing rules that allow *Coverdell Education Savings Accounts* (also known as education IRAs) to pay qualified K-12 expenses (as well as college costs).

Certain Rollovers From 529 Plan To An *"ABLE Account."* ***Starting in 2018,*** the *New Law* allows qualifying distributions from a 529 Plan to be rolled over within 60 days to an ***ABLE Account*** (i.e., tax-favored savings account for qualified beneficiaries who are disabled or blind). To qualify, the distribution must be made either: **1)** From the designated disabled beneficiary's 529 Account to the same disabled beneficiary's ABLE Account; or **2)** From any individual's 529 plan to the ABLE Account of a *"qualifying"* family member of the individual. More specifically, a non-disabled individual could rollover a qualifying distribution from the individual's 529 Account to the ABLE Account set up for any of the individual's following qualifying disabled family members: **1)** Spouse; **2)** Child or descendant of a child; **3)** Brother, sister, stepbrother, or stepsister; **4)** Father, mother, or ancestor of either; **5)** Stepfather or stepmother; **6)** Niece or nephew; **7)** Aunt or uncle; **8)** In-law; **9)** The spouse of any individual described in **1)** through **8);** or **10)** Any first cousin. **Caution!** The rollover amount counts toward the overall annual limit on contributions to the ABLE Account (i.e., $15,000 for 2018). If the rollover amount and the other contributions to the ABLE Account subject to the $15,000 limit for the year exceed the annual contribution limitation, the excess is included in the 529 plan beneficiary's income.

New Exclusion For Certain Student Debt Discharges. ***Effective for discharges after 2017 and before 2026,*** the *New Law* provides that any income resulting from the discharge of certain student debt on account of the ***death or total and permanent disability*** of the student is excluded from taxable income for ***discharges after 2017.***

ESTATE AND GENERATION-SKIPPING TRANSFER TAXES

Current Unified Exclusion Amount And GST Exemption Amount Doubled. ***Effective for individuals dying and generation-skipping transfers after 2017 and before 2026,*** the *New Law* increases the ***Basic Unified Exclusion Amount*** for gift and estate tax purposes and the generation-skipping exemption amount ***to $10,000,000*** (***as indexed*** for inflation [i.e, ***$11,200,000 for 2018***]). Previously, the exclusion and exemption amounts for 2018 were scheduled to be $5,600,000. **Planning Alert!** The *New Law* did not change the current law provision allowing a deceased spouse's estate to elect to transfer the deceased spouse's unused *Exclusion Amount* (i.e., the portability election) to the surviving spouse. **Planning Alert!** Since the increased unified exclusion amount for gifts and the increased exemption for generation-skipping transfers are only available for gifts and generation-skipping transfers through 2025, individuals should examine their estate and gift tax plans in light of this temporary opportunity to make additional tax-free transfers. Feel free to call us if we can help with your estate plan.

<u>SELECTED TAX REFORM PROVISIONS PRIMARILY IMPACTING BUSINESSES</u>

(**<u>Please note</u>,** unless indicated otherwise, each of the changes below **have no scheduled sunset date**)

<u>TAXATION OF BUSINESS INCOME</u>

<u>Reduction In Corporate Tax Rate.</u> For tax years ***beginning after 2017,*** the *New Law* provides for a flat tax rate of 21% (down from a top 35% rate) for regular "C" corporations. *"Personal Service Corporations"* (PSCs) are also subject to the flat 21% tax rate (down from a 35% flat tax rate). A *PSC* is generally a "C" corporation that is primarily in the business of providing services in the areas of health, law, accounting, engineering, architecture, actuarial sciences, performing arts, or consulting.

<u>Repeal Of Corporate Alternative Minimum Tax (AMT).</u> The *New Law* ***repeals*** the ***corporate AMT*** for ***tax years beginning after 2017.*** A corporation will be allowed a ***refundable credit*** for each of the ***tax years beginning in 2018, 2019, and 2020*** equal to ***50%*** of unused AMT credit carryovers to those respective years in excess of the regular tax for those years. *Any* ***AMT credit carryover amount*** that remains unused after applying it to the ***2021*** regular tax is 100% refundable. Consequently, the ***entire corporate AMT credit*** that carries over beyond 2017 will be recouped either as a reduction in post-2017 corporate income tax and/or a refundable credit ***no later than 2021.***

<u>Decreased Dividends Received Deduction.</u> Under prior law, "C" corporations that received dividends from other corporations were entitled to a deduction for dividends received. If the corporation owned at least 20% of the stock of another corporation, an 80% dividends received deduction was allowed. Otherwise, a 70% deduction was allowed. ***After 2017,*** the *New Law* reduces ***the 80%*** dividends received deduction ***to 65%*** and reduces ***the 70%*** dividends received deduction ***to 50%.***

<u>NEW 20% DEDUCTION FOR QUALIFYING INCOME</u>

<u>Background.</u> Since Congress reduced the top tax rate for "C" corporations from 35% to 21%, it felt certain types of business income from pass-through entities (e.g., S Corporations, Partnerships, Sole Proprietors, Trusts, and Estates), and the income of certain Cooperatives, should also get some form of tax rate reduction. However, instead of providing a lower tax rate for this type of business income, ***effective for tax years beginning after 2017,*** the *New Law* creates a new 20% deduction that is generally provided to noncorporate taxpayers receiving qualifying income. **<u>Planning Alert!</u>** Although not discussed in detail in this letter, a similar 20% deduction is allowed to certain agricultural and horticultural cooperatives that satisfy specific criteria. **<u>Caution!</u>** While most new tax provisions primarily impacting businesses under the *New Law* do not have an expiration date, ***this 20% deduction <u>does expire after 2025!</u>***

<u>Income Qualifying For The 20% Deduction.</u> The following types of income generated by partnerships, S corporations, sole proprietorships, trusts, and estates may qualify for the 20% deduction: *"Qualified Business Income*," *"Qualified Cooperative Dividends," "Qualified REIT Dividends,"* and *"Qualified Publically-Traded Partnership Income."* ***<u>Please note that,</u>*** of these four types of qualifying income, the most common will, in all likelihood, be ***"Qualified Business Income"*** *(*QBI). Consequently, the remainder of this discussion focuses ***only on QBI.***

<u>"Qualified Business Income."</u> ***"Qualified Business Income"*** **(QBI)** is generally defined as the net amount of qualified items of income, gain, deduction, and loss with respect to ***"any"*** trade or business ***<u>other than</u>*:** **1)** Certain ***personal service*** businesses known as ***"Specified Service Trade Or Businesses"*** (described in more detail below), and **2)** The ***trade or business*** of performing services ***"as an employee."***

- **<u>QBI *does not include:*</u>** **1)** Dividends, investment interest income, short-term capital gains, long-term capital gains, income from annuities, commodities gains, foreign currency gains, etc., **2) Reasonable compensation** paid ***by a qualified trade of business for services rendered*** to the taxpayer claiming the 20% deduction, **3)** Any ***"guaranteed payment"*** paid to a partner for services actually rendered to or on behalf of the partnership, or **4)** To the extent provided in regulations, any amount allocated or

distributed by a partnership ***to a partner*** who is ***acting other than in*** his or her capacity as a partner for services rendered to a partnership.

Determining The Amount Of A Taxpayer's 20% Deduction Where The Only Income Qualifying For the 20% Deduction Is "Qualified Trade or Business Income."

Step 1 – Calculate The Initial Deduction Amount With Respect To The Taxpayer's Share Of Each "Qualified Trade Or Business." The initial deduction amount for each *"Qualified Trade or Business* interest is the ***lesser of:*** **1)** ***20%*** of the owner's share of ***"Qualified Business Income" (QBI)*** from the owner's interest in each **"*Qualified Trade or Business,*"** or **2)** The ***owner's share*** of the ***W-2 Wage and Capital Limitation*** (if applicable) for each such trade or business interest.

Step 2 –Total The Initial Deduction Amounts From Each "Qualified Trade or Business" Interest. Add the initial deduction amounts in **Step 1** for each *"Qualified Trade or Business"* interest. This is the taxpayers' tentative deduction.

Step 3 – Apply Overall Limitation. The ***aggregate deductions computed in Step 2 cannot exceed 20%*** of the ***excess*** of the taxpayer's ***"taxable income"*** over the taxpayer's ***"net capital gains."***

W-2 Wage And Capital Limitation. The *"W-2 Wage and Capital Limitation"* is **the greater of: 1)** 50% of the taxpayer's allocable share of the business's W-2 wages paid with respect to each *"Qualified Trade or Business"* properly allocable to *"Qualified Business Income,"* or **2)** The sum of 25% of the taxpayer's allocable share of W-2 wages with respect to each "Qualified Trade or Business" plus 2.5% of the taxpayer's allocable share of unadjusted basis of tangible depreciable property held by the business at the close of the taxable year and which is used for the production of *"Qualified Business Income."* **Observation.** This limitation is generally designed to ensure that the maximum 20% deduction is available only to qualified businesses that have sufficient W-2 wages, sufficient tangible depreciable business property, or both.

- **Owners Exempt From The W-2 Wage And Capital Limitation.** Otherwise qualifying owners of pass-through entities ***are entirely exempt*** from the *W-2 Wage And Capital Limitation* if the owner's ***"taxable income"*** (computed without regard to the 20% deduction) does ***not exceed $157,500 or $315,000*** (if filing jointly). **Caution!** The *Wage and Capital Limitation* phases in as an owner's taxable income ***goes from more than $157,500 to $207,500*** **or from more than** ***$315,000 to $415,000*** (if filing jointly). For instance, assume ***Owner A*** and ***Owner B*** each ***own 50%*** of an S corporation and each files a joint return. If *Owner A* had *"taxable income"* ***below $315,000,*** she would be ***fully exempt*** from the *W-2 Wage Capital Limitation*. However, if *Owner B's "taxable income"* equaled or ***exceeded $415,000,*** he would be ***fully subject to this limitation.***

Example. Assume that taxpayer owns 50% of an S corporation (that operates a retail store). The S corporation has $700,000 of *QBI*. The taxpayer has $315,000 of *"taxable income,"* has $15,000 of *"net capital gain,"* and files a joint return. Since the taxpayer's *"taxable income"* is not over $315,000, ***he is not subject*** to the *W-2 Wage and Capital Limitation.* Therefore, his 20% deduction amount is computed as follows: ***The lesser of:*** **1)** ***$70,000*** (20% of $350,000 - the owner's share of the S corporation's QBI of $700,000), or **2)** The owner's share of the *W-2 wage and capital limitation* for the trade or business (which does not apply because owner's taxable income does not exceed $315,000). However, the deduction may not exceed 20% of the owner's *"taxable income"* ($315,000) less his *"net capital gains"* ($15,000) or $300,000. Therefore the amount of the owner's 20% deduction ***is limited to $60,000*** ($300,000 x 20%).

"Specified Service Trade Or Businesses" Do Not Qualify For The 20% Deduction Unless Owner's Taxable Income Less Than $415,000/$207,500. A ***"Specified Service Trade or Business"*** (SSTB) generally does not qualify for the 20% deduction. An *SSTB* is any trade or business activity involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees, or any trade or business involving the services of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. **Note!** An *"SSTB"* ***does not include*** the performance of ***architectural or engineering*** services.

- **Certain Owners Of An SSTB May Qualify.** The 20% deduction ***is allowed*** for an owner of an SSTB if the owner's *"taxable income"* (computed without regard to the 20% deduction) ***does not exceed $157,500*** or ***$315,000*** *(if filing jointly)*. The deduction is phased-out as an owner's taxable income goes from more than $157,500 to $207,500 or from more than $315,000 to $415,000 (if filing jointly).

- **Example.** Assume the taxpayer is a physician who owns 50% of an S corporation (that operates the physician's medical practice) and the S corporation has $700,000 of *QBI*. The taxpayer has $315,000 of *"taxable income,"* $15,000 of *"net capital gain,"* and files a joint return. Since the taxpayer's ***"taxable income"*** **is** ***not over $315,000*****: 1)** She may qualify for the 20% deduction even though she is the owner of an SSTB, and **2)** She ***is not subject to*** the *W-2 Wage and Capital Limitation* (i.e., her taxable income on her joint return does not exceed $315,000). Therefore, her 20% deduction amount is computed as follows: ***The lesser of:*** **1) $70,000** (20% of $350,000 - the owner's 50% share of the S corporation's QBI of $700,000), or **2)** The owner's share of the *W-2 Wage and Capital Limitation* for the trade or business (which does not apply because owner's taxable income does not exceed $315,000). However, the deduction may not exceed 20% of the owner's *"taxable income"* ($315,000) less her *"net capital gains"* ($15,000) which equals $300,000. Therefore the amount of the owner's 20% deduction ***is $60,000*** ($300,000 x 20%).

Other Rules. The 20% deduction: **1)** Does ***not reduce*** the owner's ***"self-employment" income*** for purposes of determining S/E Tax, **2)** Does ***not reduce*** the owner's ***"adjusted gross income"*** (AGI), although it ***does reduce*** the owner's ***"taxable income,"*** and **3)** Is available to taxpayers using the standard deduction.

General Planning Observations Regarding The 20% Deduction. In light of these rules, owners of pass-through entities should consider the following:

- **W-2 Employee vs. Owner.** An *"employee"* of a business that generates QBI would not qualify for the 20% deduction for his or her W-2 wages, but the owner of the same pass-through business would qualify with respect to the owner's share of the business's pass-through QBI. Consequently, employees (particularly higher-paid employees) will have a tax incentive to become *"owners"* of their pass-through employers, rather than merely W-2 employees.

- **W-2 Compensation Paid To S Corp Owner/Employee.** Currently, S corporation shareholder/ employees have an incentive to pay themselves W-2 wages as low as possible because only the shareholder's W-2 income from the S corporation is subject to FICA taxes. Other income of the shareholder from the S corporation is generally not subject to FICA or Self-Employment (S/E) taxes. However, if the IRS determines that an S corporation shareholder/employee has taken unreasonably *"low"* compensation from the S corporation, the IRS generally argues that other amounts the shareholder has received from the S corporation (e.g., distributions) are disguised *"compensation"* and should be subject to FICA taxes. In light of the new 20% deduction, S corporation shareholder/employees have an additional tax incentive to keep their W-2 wages as low as possible. This is because their W-2 wages do not qualify for the new 20% deduction, while their pass-through *Qualified Business Income* will qualify. **Planning Alert!** With this new 20% deduction, the Service will have an additional reason to closely scrutinize whether the W-2 wages paid to an S corporation's shareholder/employee is unreasonably low.

- **Payments By A Partnership To A Partner For Services.** As noted above, a partner's ***pass-through*** share of *Qualified Business Income* ***does qualify*** for the ***20% deduction*****,** while the 20% deduction ***does not apply*** to: **1)** Any amount that is a ***"guaranteed payment"*** for services actually rendered to or on behalf of a partnership, or **2)** As provided in regulations to be issued by the IRS, any amount allocated or distributed by a partnership ***to a partner*** who is ***acting other than in*** his or her capacity as a partner for services. Presumably, going forward it appears likely the IRS will more closely scrutinize whether a partner who is providing services to the partnership in a capacity other than a partner is being paid adequate compensation-type payments by the partnership.

- **Owners Of A"Specified Service Trade Or Businesses" (SSTB).** As discussed above, even though owners of an SSTB generally do not qualify for the 20% deduction, they do qualify fully if their taxable income does not exceed $157,500 or $315,000 (if filing a joint return). Consequently, starting in 2018,

owners of SSTBs will place a premium on potential deductions that could cause their taxable income to drop below the $315,000 or $157,500 thresholds. **Planning Alert!** As discussed in the immediately following segment, the *New Law* has significantly increased the amount that can be immediately deducted under Sections 179 and 168(k) for purchases of qualifying depreciable property. In certain situations, these increased deductions could give owners of an SSTB a significant tax benefit by preserving the 20% deduction for "Qualified Business Income" (e.g., by reducing the owner's taxable income below the income thresholds that will allow the SSTB owner to take all or a portion of the 20% deduction).

EXPANDED WRITE-OFFS FOR CERTAIN CAPITAL EXPENDITURES

Background. The *New Law* dramatically increases the first-year deductions that may be taken for business assets qualifying for the §179 deduction and the §168(k) bonus depreciation deduction.

100% First-Year 168(k) Bonus Depreciation Deduction. For the past several years, one of the most popular tax-favored deductions has been the *168(k) Bonus Depreciation* deduction. Under prior law, the 168(k) deduction was equal to 50% of the cost of qualifying **new** depreciable assets placed-in-service during 2017, and was scheduled to drop to 40% for 2018. However, the *New Law* increases the *168(k) Bonus Depreciation* deduction ***to 100%*** for qualifying **new and *"used"*** property *acquired and placed-in-service* ***after September 27, 2017*** and ***before January 1, 2023.***

- **"Used" Property Qualifies.** Previously, only **new** qualifying property was eligible for the *168(k) Bonus Depreciation Deduction*. For qualifying property acquired and placed-in-service ***after September 27, 2017,*** the *New Law* allows the *168(k) Bonus Depreciation* to be taken on ***"new" or "used"*** property. Therefore, under the *New Law,* property that generally qualifies for the *168(k) Bonus Depreciation* includes ***"new"*** or ***"used"*** business property that has a depreciable life for tax purposes of ***20 years or less*** (e.g., machinery and equipment, furniture and fixtures, sidewalks, roads, landscaping, computers, computer software, farm buildings, and qualified motor fuels facilities). **Caution!** Although used property acquired and placed-in-service after September 27, 2017 may qualify for the 168(k) depreciation deduction, used property will not qualify for the 168(k) depreciation deduction if the property was previously used by the taxpayer (or by certain parties related to the taxpayer).

- **Business Vehicles.** Vehicles used primarily in business generally qualify for the *168(k) Bonus Depreciation*. However, there is a dollar cap imposed on business cars and trucks that have a ***loaded vehicle weight of 6,000 lbs or less.*** More specifically, vehicles ***acquired and placed-in-service in 2017*** and used 100% for business are allowed ***maximum depreciation*** (including the Section 179 deduction as discussed below) ***of $3,160*** ($3,560 for trucks and vans) ***for 2017.*** However, these caps are ***increased by $8,000*** (i.e., to $11,160 and $11,560 for trucks and vans) for qualifying vehicles. For qualifying vehicles ***acquired and placed-in-service after September 27, 2017*****,** the *New Law* retains this *$8,000 increase* ***through 2022.*** Moreover, for qualifying vehicles placed-in-service ***after 2017,*** the *New Law* increases the annual depreciation caps (without regard to the $8,000 increase) as follows: **1st year - $10,000** (up from $3,160 if placed-in-service in 2017); **2nd year - $16,000** (up from $5,100); **3rd year - $9,600** (up from $3,050); **fourth and subsequent years - $5,760** (up from $1,875).

- **Qualified Improvement Property Placed-in-Service After 2017.** ***"Qualified Improvement Property"*** placed-in-service after 2017 ***should qualify*** for the ***168(k) Bonus Depreciation Deduction*** since Congress reduced the depreciable life of "*Qualified Improvement Property"* generally from 39 years to 15 years for property placed-in-service after 2017 (i.e., as mentioned earlier, depreciable, tangible, property with a depreciable life of ***20 years or less*** qualifies for the *168(k) Bonus Depreciation Deduction*). ***"Qualified Improvement Property"*** (QIP*)* is generally an improvement to the ***interior portion*** of a ***commercial building*** (provided the improvement is not attributable to an enlargement of the building, elevators or escalators, or the internal structural framework of the building), if the improvement is placed-in-service after the building was first placed-in-service. **Practice Alert!** The change of the depreciable life for *"Qualified Improvement Property"* from 39 years to 15 years is outlined in the Conference Committee Reports. However, the change was not made to the applicable statute. Congress has indicated *they intended for "Qualified Improvement Property" to have a 15-year life and the omission from the statutory language was an oversight.*

<u>Expansion Of The 179 Deduction.</u> Another popular and frequently-used business tax break is the up-front Section 179 deduction (*"179 Deduction"*). Generally the *New Law* makes the following changes to the 179 Deduction:

- **<u>Increased Caps.</u>** Effective for ***property placed-in-service in tax years beginning after 2017,*** the *New Law* ***increases the 179 Deduction limitation*** to ***$1,000,000*** (up from $510,000 for 2017) and increases the ***phase-out threshold*** to ***$2,500,000*** (up from $2,030,000 for 2017). These caps are to be indexed for inflation after 2018. Also, the $25,000 cap for SUVs remains, but will be indexed for inflation beginning in 2019.

- **<u>Qualifying Property Generally Expanded.</u>** Generally, "*depreciable*" property qualifies for the ***179 Deduction*** if: **1)** It is purchased ***new or used,*** **2)** It is *"tangible personal"* property, **and 3)** It is used primarily for business purposes (e.g., machinery and equipment, furniture and fixtures, business computers, etc.). Off-the-shelf business software also qualifies. **<u>Planning Alert!</u>** Prior law did not allow the 179 deduction for property used in ***connection with lodging*** (other than hotels, motels, etc.). ***Effective for property placed-in-service in tax years beginning after 2017,*** the *New Law* removes this restriction, so the *179 Deduction* ***is now allowed*** for otherwise qualifying property used in connection with lodging.

- **<u>"Qualified Real Property" Definition Modified.</u>** Under prior law, property that qualified for the *179 Deduction* included ***"Qualified Real Property,"*** which was defined as: **1) *"Qualified Leasehold Improvement Property"*** (generally improvements to the interior portion of a non-residential building subject to a lease between unrelated parties where the improvements were placed-in-service more than 3 years after the commercial building itself was placed-in-service); **2) *"Qualified Retail Improvement Property"*** (generally improvements to certain buildings open to the general public for the retail sale of tangible personal property); and **3) *"Qualified Restaurant Property"*** (generally expenditures for the improvement, purchase, or construction of a building, if more than 50% of the building's square footage is devoted to the preparation of, and seating for, the on-premises consumption of prepared meals).

  Effective for *<u>property placed-in-service in tax years beginning after 2017,</u>* the *New Law* changes the definition of ***"Qualified Real Property"*** to mean **1) *"Qualified Improvement Property"*** and **2) *"Specified Improvements To Commercial Real Property."*** Therefore, ***for property placed-in-service in tax years beginning after 2017,*** capital improvements to commercial buildings that, under prior law, would have been classified as "*Qualified Leasehold Improvement Property," "Qualified Restaurant Property,"* or *"Qualified Retail Improvement Property,"* will qualify for the 179 deduction ***only if*** the property constitutes **1)*"Qualified Improvement Property,"*** *or* **2) *"Specified Improvements To Commercial Real Property."***

- ***<u>"Qualified Improvement Property"</u>*** (as discussed previously) is generally an improvement to the ***interior portion*** of a ***commercial building*** (provided the improvement is not attributable to an enlargement of the building, elevators or escalators, or the internal structural framework of the building), if the improvement is placed-in-service after the building was first placed-in-service.

- **<u>"Specified Improvements To Commercial Real Property"</u>** generally include any of the following improvements to nonresidential real property ***placed-in-service after the date such property was first placed-in-service:*** **1)** Roofs, **2)** Heating, ventilation, and air-conditioning property, **3)** Fire protection and alarm systems, **and 4)** Security systems.

<u>Planning Alert!</u> Determining whether a major repair to a building's roof should be capitalized or deducted immediately as a repair under the voluminous capitalization regulations, is not always an easy task. Since new roofs with respect to an existing commercial building may qualify for the Section 179 deduction after 2017, in many situations the *"capitalization vs. repair"* issue relating to the replacement of roofs should largely be eliminated where the 179 limitations for the year are not exceeded.

<u>Other Changes To Depreciation Rules.</u> Generally, ***effective for property placed-in-service after 2017,*** the *New Law*: **1)** Shortens the recovery period for machinery or equipment used in a farming business from

7 to 5 years, **2)** Repeals the requirement that property used in farming business use the 150% declining balance depreciation method, **3)** Provides a recovery period for ***"Qualified Improvement Property"*** (defined previously) of ***15 years,*** and **4)** As discussed above, eliminates the separate definitions of *"Qualified Leasehold Improvement Property," "Qualified Restaurant Property,"* and *"Qualified Retail Improvement Property."*

SIMPLIFIED ACCOUNTING FOR CERTAIN SMALL BUSINESSES

Overview. ***Generally effective for tax years beginning after 2017,*** the *New Law* provides the following accounting method relief for qualifying businesses: **1)** Increases the average gross receipts (for the past three years) safe harbor for "C" corporations to use the cash method of accounting from $5 million to $25 million, **2)** Generally allows businesses with average gross receipts (AVGRs) for the preceding three tax years of $25 million or less to use the cash method even if the business has inventories, **3)** Generally allows simplified methods for accounting for inventories for businesses with AVGRs for the preceding three tax years of $25 million or less, **4)** Generally exempts businesses with AVGRs for the preceding three tax years of $25 million or less from applying UNICAP, and **5)** Liberalizes the availability of the completed-contract method for certain businesses with AVGRs for the preceding three tax years of $25 million or less.

CHANGES TO NOLs AND DEDUCTIONS FOR BUSINESS INTEREST

New Limits On Business Interest. ***Effective for tax years beginning after 2017,*** the *New Law* generally provides that businesses may not deduct interest expense for a taxable year in excess of **1)** Interest income, plus **2)** 30% of the business's adjusted taxable income, plus **3)** Floor plan financing interest. Any excess is carried over to subsequent years for an unlimited number of years. The *New Law* also ***generally exempts businesses*** with ***Average Gross receipts*** for the preceding three tax years ***of $25 million or less*** from this new interest expense deduction limitation. Real property trades or businesses and farming businesses may elect out of the limitation if the businesses average gross receipts exceed $25 Million. However, an electing business will be required to use the alternative depreciation method for certain assets. Please call our firm if you need additional details concerning this new interest deduction limitation.

Modifications To The NOL Deduction. The *New Law generally* makes the following changes to the NOL deduction: **1)** ***For net operating losses (NOLs) arising in tax years beginning after 2017***, repeals the prior law 20-year limitation on the number of years to which an NOL could be carried forward; **2)** ***Net operating losses (NOLs) arising in tax years beginning after 2017*** and carried to future years will not be allowed to offset more than 80% of taxable income before the NOL deduction; and **3)** ***For net operating losses (NOLs) arising in tax years beginning after 2017***, repeals the ability to carry back an NOL to previous years, except the *New Law* allows NOLs attributable to certain farming businesses and certain property and casualty insurance companies to be carried back to the 2 prior tax years.

OTHER SELECTED MISCELLANEOUS BUSINESS CHANGES

The New Law also made changes and modifications to the following selected business provisions:

Changes To §1031 Like-Kind Exchanges. Generally, ***effective for exchanges completed after 2017,*** the *New Law* allows Section 1031 like-kind exchanges ***only with respect*** to ***real property*** that is held in a trade or business or for investment. The *New Law* does not change the existing rule that disallows Section 1031 exchanges for *"dealer"* real estate (i.e., real estate held primarily for sale to customers in the ordinary course of taxpayer's trade or business). The *New Law* provides a transition rule allowing like-kind exchanges of personal property to be completed if the taxpayer either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017.

Repeal Of Section 199 Deduction For Income Attributable To Domestic Production Activities.

- **Effective For Taxable Years Beginning After 2017 For Taxpayers Other Than C Corporations.** The *New Law* generally repeals the deduction for domestic production activities ***effective for tax years beginning after December 31, 2017.***

<u>Repeal Of Deductions For Certain Entertainment, Amusement, Recreation Activities, Membership Dues, Etc.</u> ***Effective for amounts paid or incurred after 2017,*** the *New Law* repeals all deductions with respect to: **1)** An activity generally considered to be entertainment, amusement or recreation, **2)** Membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or **3)** A facility or portion of a facility used in connection with any of the above. **<u>Planning Alert!</u>** The *New Law* ***did not repeal*** the deduction for 50% of food and beverage expenses associated with operating a trade or business (e.g., meals consumed by employees during away from home travel).

<u>Changes For Meals Provided To Employees On Employer's Premises.</u> Under prior law, an employer could generally ***deduct 100%*** of the cost of business meals that were excludable from the income of employees because they were provided at an employer-operated eating facility ***for the convenience of the employer.*** The *New Law* generally retains this provision with the following modifications: **1)** ***Effective for amounts incurred and paid after 2017 and before 2026,*** the employer ***may deduct only 50%*** (down from 100%) of these employer-provided meals at an employer-operated eating facility, and **2)** ***Effective for amounts paid or incurred <u>after December 31, 2025,</u>*** the *New Law* ***repeals the deduction altogether*** for these employer-provided meals at an employer-operated eating facility.

<u>Repeal Of Technical Termination Of Partnerships.</u> Under *prior law*, for tax purposes, a partnership was deemed terminated if there was a ***sale or exchange of 50% or more*** of the total interest in partnership capital and profits. This so-called *technical termination* generally caused: **1)** Some of the tax attributes of the old partnership to be terminated, **2)** The partnership's taxable year to be closed (potentially resulting in short tax years), **3)** Partnership-level elections generally to be terminated, and **4)** The partnership depreciation recovery periods to be restarted. ***Effective for partnership tax years beginning after December 31, 2017,*** the *New Law* ***repeals altogether this technical termination rule*** related to the sale or exchange of 50% or more of the partnership interests.

<u>Carried Interest.</u> ***Effective for taxable years beginning after 2017,*** the *New Law* essentially increases a partnership's long-term capital gain holding period from 1 year to 3 years for pass-through capital gains that pass-through to certain partners holding an interest in a partnership received for performing services. The provision would generally apply to a partner who received his or her partnership interest in connection with the performance of substantial services in a trade or business activity that involves the raising of capital and either investing or developing certain assets (e.g., securities assets, rental or investment real estate).

<u>New Employer Credit For Qualified Paid Family Leave Program.</u> ***Generally effective for wages paid in tax years beginning after 2017 and before 2020*** **(i.e., for 2018 and 2019),** the *New Law* allows a new employer business credit for certain payments to employees pursuant to a qualified family and medical leave program. This business credit is generally allowed for employers that provide at least two weeks of annual paid family and medical leave to full-time employees. The credit equals 12.5% of the wages paid during a qualified family or medical leave if the employee receives at least 50% of normal pay during the leave. The credit is increased by .25 percentage points (but not above 25%) for each percentage point by which the rate of pay exceeds 50%. The maximum amount of family and medical leave that may be taken into account for any one employee for a tax year is 12 weeks.

<u>FINAL COMMENTS</u>

The ***Tax Cuts And Jobs Act Of 2017*** is mammoth in its scope and reach, and we have attempted to discuss only selected provisions that we believe will have the greatest impact on the largest number of our clients. If you have heard of a provision in the New Law that we did not address in this letter (or if you want additional information on a topic we did discuss), please contact us. In addition, please call us before implementing any planning ideas discussed in this letter, or if you need additional information. **Note!** The information contained in this material represents a general overview of selected provisions in the ***Tax Cuts And Jobs Act Of 2017***

and should not be relied upon without an independent, professional analysis of how any of the items discussed may apply to a specific situation.

DISCLAIMER

Any tax advice contained in the body of this material was not intended or written to be used, and cannot be used, by the recipient for the purpose of promoting, marketing, or recommending to another party any transaction or matter addressed herein. The preceding information is intended as a general discussion of the subject addressed and is not intended as a formal tax opinion. The recipient should not rely on any information contained herein without performing his or her own research verifying the conclusions reached. The conclusions reached should not be relied upon without an independent, professional analysis of the facts and law applicable to the situation.