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The Tax Cuts and Jobs Act Sprint to the Finish Line

Victoria S. Carlin, CPA vcarlin@dopkins.com December 2017

The Senate and the House Conciliation Committee released their "final" version of the Tax Cuts and Jobs Act on Friday evening. The intention is to vote on it today and tomorrow with the goal of sending it to the White House for signature on Wednesday. The Committee, in essence, started with the Senate version and made changes from there.

The individual tax provisions as discussed here, including the pass-through deduction, will expire in 2026 unless they are extended in the future. This bill may still be subject to some changes to fit within the Senate's rules to prevent any filibuster activity before its final passage. Also as the ramifications of some of the provisions become known, there is certain to be some follow-up legislative activity. That said, here is a high-level general summary of some of what made it into the final version.

Please pardon the length as at over 500 pages there is a lot to cover. Due to space constraints, I have not included any international or exempt organization provisions.

WHAT SURVIVED

For individuals, the Child and Dependent Care Credit, the Adoption Credit, the Earned Income Credit, Electric Vehicle Credit, various college credits, student loan interest and qualified tuition deductions, MSA contribution deductions, educator deduction, employer provided housing exclusion, sale of principal residence gain exclusion, and retirement savings options such as 401(k)s and IRAs all still exist. The maximum rates on capital gains and qualified dividends remains unchanged although the brackets have shifted. Annual IRA contribution conversions still are allowed although some recharacterizations (such as unwinding a ROTH conversion) are not.

For businesses, the Low Income Housing Credit, Research and Development Credit, New Markets Credit, Disabled Access Credit, Tips Credit, and Work Opportunity Credit have all survived. The tax preferred status of private activity bonds also managed to remain the same.

WHAT GOT THE AXE

For individuals, personal exemptions, alimony deductions for new agreements created and some agreements modified after 2018, moving expense deduction and employer reimbursement exclusion for non-military, the limitation on itemized deductions, all miscellaneous itemized deductions subject to the 2% floor (such as investment advisor fees) were all eliminated. Home equity interest will no longer be deductible at all regardless of what it was used for. The ACA mandate payment was set to zero.

The bill eliminates the Alternative Minimum Tax for corporations. Net operating loss carrybacks, with the exception of NOLs due to declared disasters, will no longer be allowed. The Domestic Production Activity Deduction (aka Section 199 or DPAD), which was created to spur manufacturing activity, has also been eliminated. Like-kind exchanges will no longer be tax free with the exception of real property not held primarily for sale. All entertainment expenses and membership dues are no longer deductible.

WHAT CHANGED FOR INDIVIDUALS

For the next 8 years (until 2026), individuals will still have 7 tax brackets like before. However, both the tax rates and the bracket income levels are changing and are more in-line with the Senate version with the top bracket being decreased to 37%. The tax on the unearned income of children will no longer be dependent on the parents' taxes, but instead will follow the trust tax brackets.

Casualty losses incurred in 2016 and 2017 in a Presidentially Declared Disaster Area have been moved to an above the line deduction and must only be in excess of $500.

For standard deductions, the new amounts will follow the Senate version and be increased to $ 24,000 Married Filing Joint, $18,000 Head of Household, and $12,000 for everyone else.

For itemized deductions, the medical deduction has survived with the base deduction changed from the current 10% AGI down to 7.5% for the next 2 years. While state and local income and sales taxes did survive, the total deduction for those plus real estate taxes will now be capped at a maximum $10,000. The bill also specifically prohibits the prepayment of any 2018 or after state and local income taxes in 2017. The taxes limitation does not apply to any incurred in carrying on a trade or business, such as real estate taxes for a rental. The interest on any new home acquisition debt incurred after December 15th will be limited to the interest on the first $750,000. Older debt will be limited to $1,000,000 of principle. The limitations on cash contributions to certain charities has increased

Pass-through business losses in excess of business income plus up to an additional $250,000 ($500,000 joint), for anyone other than a corporation, will now be carried forward treated the same as a Net Operating Loss. Net Operating Loss carryforwards will be limited to offsetting only 80% of future income.

A new qualified business income deduction was created to provide pass-through owners with some of the benefits of a reduction in business tax rates. While the explanation of the calculation is over 7 pages long, the general idea is that 20% of the qualified business income of a qualified trade or business would be allowed as an additional deduction to taxable income (not adjusted gross income). There are restrictions on the type of businesses that will qualify, the income at which the deduction will be phased out, and a phased in maximum amount allowable as compared to W-2 wages paid. The calculation is performed on an aggregate basis, including all qualified trades or businesses during the year. Like the other individual provisions, this is set to expire in 2026.

The Alternative Minimum Tax for individuals still exists but the exemption amount has been increased to exclude more individuals.

The child tax credit has been increased to $2,000 per qualifying child with the phaseout threshold substantially increasing to $400,000 married joint ($200,000 otherwise) meaning more people will now qualify for the credit. The refundable portion of the credit has been increased to $1,400. In addition, a new non-refundable qualifying dependent credit of $500 will be allowed for any dependent who is not a qualifying child.

Estate and Gift Tax is no longer on the chopping block. Instead, the exemption of $5.5 Million will be doubled to $11 Million for any estates of decedents dying and gifts made between 2018 and 2025. After 2025, the amount will reset back to today's levels.

WHAT CHANGED FOR BUSINESSES

The tax rate for all tax paying corporations, including personal service corporations, will be a flat 20%.

The dividends received deduction will be reduced from 80% and 70% to 65% and 50% respectively.

Bonus depreciation has been reset to 100% for any qualified property acquired after September 27, 2017 through 2022 with a 20% reduction each year from 2023 to 2026. The definition of qualified property has been expanded to include both new and used property. The depreciable life of any farming equipment is reduced from 7 to 5 years. Also the requirement farms use the 150% depreciation method is repealed for any items not subject to a 15 or 20 year life. The Section 179 deduction is being increased to $1,000,000 with the phase out also increased to $2,500,000. However, the $25,000 limitation for SUVs remains the same.

The gross receipts limitation for a business to use the cash accounting method is being increased to $25 Million. The new limit will apply to all businesses, including family farming corporations, and will be applied to the maintenance of inventory, application of unicap, and small construction percentage of completion requirements as well as the exemption from the new interest expense limitations.

With the exceptions of floor plan financing, farms, real estate, utilities, and qualified small businesses, the deduction of any interest expense will be severely limited. In most cases the deductible amount will be limited to the sum of business interest income plus 30% of an adjusted taxable income (essentially taxable income before interest and depreciation/amortization until 2022). However, there are some anti-double counting rules for pass-through businesses. Also, a farm business electing out of the interest limitations must use the ADS method of depreciation.

Specified research and experimental expenses must be capitalized and amortized over 5 years. Any that are incurred outside of the US are subject to a 15 year amortization. Any remaining basis for items disposed or abandoned must continue to be amortized rather than expensed.

Net Operating Loss carrybacks have been eliminated with a few very limited exceptions. The NOL carryover deduction will be reduced from the current 100% to 80% of taxable income

While the Rehabilitation Credit has survived, it has under gone substantial changes, eliminating the 10% credit and modifying the 20% credit.

A new employer credit for paid family and medical leave has been created. A minimum 12.5% credit for "eligible employers" who pay at least 50% of the normal wages of an employee will be allowed in 2018 and 2019.

While the corporate changes are most likely here to stay, whether or not we experience a "reset" to our current rules in the year 2026 remains to be seen. For the foreseeable future, these new rules will "change the game" on any previous tax planning that has been done. Updating current business structures and personal tax plans will be crucial in the next few months.

For more information, please contact:

Victoria Carlin
Tax Manager
vcarlin@dopkins.com ▪ (716) 634-8800

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