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TAX CUTS AND JOBS ACT—WHAT'S IN IT FOR YOU?

James R. Hasselback*

The Tax Cuts and Jobs Act (The Act), HR 1, was signed by President Trump on December 22, 2017. The more than 500 pages bill overhauls the Tax Code to an extent not seen in 30 years. This summary of the tax law discusses each provision that the House and Senate bills and provides the final results of each provision. The discussion also provides the law that was in effect prior to the new law.

Timing of Provisions

Most of the provisions begin January 1, 2018, and most of the individual tax cuts are scheduled to expire after 2025. Only the corporate tax rate and the Affordable Care's individual mandate were made permanent. The 7.5% provision of medical expenses is the only provision retroactive to the beginning of 2017. There are a few items, such as bonus depreciation, that are retroactive to dates late in 2017.

Budget Effects

The Joint Committee on Taxation's report on the estimated budget effects of the bill predicts that is will result in a net federal revenue loss of $1.456 trillion form 2018 through 2027. Under the Senate's budget reconciliation rules, the Senate could pass the bill with only 51 votes if it does not increase the deficit by more than $1.5 trillion over that period.

Tax Provisions of the Tax Act

Alternative Inflation Adjustment

Under the pre-Act Law many parameters of the tax system that are adjusted for inflation are based on annual changes in the level of the consumer Price Index for All Urban Consumers (CPI-U). The Act requires the use of the Chained Consumer Price Index for All Urban Consumers (C-CPI-U) to adjust tax parameters currently indexed by the CPI-U.

Tax Rate Schedules

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

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35%	$400,000–600,000	$200,000–500,000
37%	over $600,000	over $500,000

The number of brackets remains at seven. However, the tax rates are lowered, and the bracket ranges are larger than in the past. For 2017, the 39.6% bracket for married filing jointly began at $470,700, compared to the 37% bracket for a joint return beginning at $600,000 for 2018.

For the first five marginal tax brackets, the income ranges for single filers are exactly half of those for married couples. This helps eliminate the marriage penalty for most households.

> **Example.** Under pre-Act law, two single individuals with each earning $150,000 would both be in the 28% tax bracket. However, if they were to get married, their combined $300,000 income would be well into the 33% marginal tax rate. Under the new brackets, this couple would be in the 24% marginal tax bracket, regardless of whether they got married or not.

Estates and Trusts

The estates and trusts tax rate schedule went from five brackets to four brackets.

Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

For 2018, the 15% capital gain rate begins at $2,600 and rises to 20% when $12,700 is reached.

Simplification of Tax on Unearned Income of Children

The new law simplifies the Kiddie Tax by effectively applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child instead of using the parent's tax rate.

As under Pre-Act Law, taxable income attributable to earned income is taxed according to an unmarried taxpayer's brackets and rates.

The child's tax is unaffected by the tax situation of the child's parent or the unearned income of any siblings.

Corporate Tax Cut

Pre-Act Law: Corporations are taxed as high as 35%.

Under the new law the corporate tax rate is a flat 21% rate beginning in 2018. Personal services corporations are subject to a flat 21% corporate tax rate. The corporate rate is permanent.

Switch from S to C Corporation

In the case of an eligible terminated S corporation, any adjustment required which is attributable to such corporation's revocation shall be considered ratably

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during the six-taxable year period beginning with the year of change. This could occur when an S corporation is required to switch from the cash method to the accrual method when switching to a C corporation.

The term eligible terminated S corporation's means any C corporations which was an S corporation on the date before the date of the enactment of the Tax Cuts and Jobs Act, and during the 2-year period beginning on the date of such enactment makes a revocation of its election under Section 1362(a), and the owners of the stock of which, determined on the date such revocation is made, are the same owners (and in identical proportions) as on the date of such enactment.

Standard Deduction

Pre-Act Law: $6,500 standard deduction of single taxpayers and $13,000 for married couples, filing jointly.

The standard deduction is increased to $24,000 for joint filers (and surviving spouses), $18,000 for head-of-household, and $12,000 for all other individual taxpayers. These amounts will be adjusted for inflation based on chained CPI. The Act retains the additional standard deduction for the aged and the blind ($1,300 for singles and $1,600 for married).

Personal Exemption

Pre-Act Law: Personal exemptions of $4,050 allowed for each family member.

The deduction for personal exemptions and the personal exemption phase-out is set at zero. All definitions regarding a dependent remain in the Code.

Filing Requirements

Taxpayers must file a tax return if their gross income exceeds the standard deduction plus the additional standard deduction for being over 65. No additional standard deduction for being blind in determining filing requirements. Personal exemptions no longer enter into the computation.

Income

Pass-Through Business Deduction

Pre-Act Law: Income is taxed at individual rates.

The Act allows a 20% deduction of the qualified business income of a qualified pass-through entity. The owners then pay tax at their personal income tax rate on the remainder.

Qualified pass-through entities include:

1) Sole proprietorships,
2) S corporations,
3) Partnerships,
4) Trusts, and
5) Estates.

Qualified Business Income does not include the following items of investment income:

1) Short-term capital gain or loss;
2) Long-term capital gain or loss;
3) Dividend income; or
4) Interest income.

Qualified Business Income does not include any wages or guaranteed payments earned as an employee.

Example: An individual owns 30% of an S corporation that pays him $40,000 of wages and allocates to him $80,000 of income. His QBI from the S corporation is only the $80,000 of income; the $40,000 of wages do not count.

The QBI deduction is equal to the sum of:

1) The lesser of:
    a) 20% of the "combined qualified business income" of the taxpayer, or
    b) 20% of the excess of taxable income over the sum of any capital gain;
        (1) Taxable income is computed without the 20% deduction.
2) Plus, the lesser of:
    a) 20% of qualified cooperative dividends, or
    b) Taxable income less net capital gain.

The deduction is limited to:

1) The lesser of:
    a) 20% of the taxpayer's qualified business income or
2) The greater of:
    a) 50% of the W-2 wages with respect to the business, or
    b) 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property.

W-2 Wages

W-2 wages are exactly that: wages paid to an employee, including any elective deferrals into a Section 401(k)-type vehicle or other deferred compensation. W-2 wages do not include, however, amounts like payments to an independent contractor or management fees, because new Section 119A(b)(4)(C) clearly states that an amount is not a W-2 wage for these purposes unless it shows up on a payroll tax return.

Qualified Property

Qualified property is defined as tangible property of a character subject to depreciation that is held by, and available for use in, the qualified trade or business

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at the close of the tax year, and which is used in the production of qualified business income, and for which the depreciable period has not ended before the close of the tax year. Land and intangibles do not qualify.

Unadjusted Basis of Qualified Property

The use of the unadjusted basis of property begins on the date the property is placed in service and ends on the later of:

a) 10 years, or

b) the last day of the last full year in the asset's regular (not ADS) depreciation period.

Example. Elam Brothers, LLC purchases machines with a seven-year life for $80,000. Even though full basis is depreciated before year 10, the machines remain qualified property through the end of year 10 if the machines are still in use generating Qualified Business Income. In year 10 the machines contribute the full $80,000 to the LLC's unadjusted basis of property calculation.

Partnerships and S Corporations

The qualified business income deduction for noncorporate taxpayer is applied to partnerships and S corporations at the partner or shareholder level. Thus, each partner or shareholder must consider his or her allocable share of each qualified item of income, gain, deduction, and loss and is treated as having W-2 wages equal to his or her allocable share of the W-2 wages of the partnership or S corporation for the tax year. A partner's or shareholder's allocable share of W-2 wages is determined in the same manner as the partner's or shareholder's allocable share of wage expense, and a partner's or shareholder's allocable share of the unadjusted basis of qualified property is determined in the same manner as the partner's or shareholder's allocable share of depreciation.

Some partners and shareholder may be eligible to take the deduction while others in the same partnership or S corporation may not because of the taxable incomes of each.

W-2 Wage Limit

The W-2 wages/qualified property limit does not apply if the taxpayer's taxable income for the tax year is equal to or less than a $157,500 threshold amount ($315,000 for taxpayers filing a joint return). Fully phased out at $207,500/ $415,000.

Example: Jerry has QBI of $200,000 from an S corporation that paid him $30,000 of W-2 wages. The S corporation paid a total of $50,000 in W-2 wages and that has no qualified property. Jerry's spouse has $60,000 of W-2 income, and Jerry and his spouse have interest income of $10,000. Thus, total taxable income is $300,000.

Normally, Jerry's deduction would be limited to $25,000, the lesser of:

1) 20% of QBI of $200,000, or $40,000, or

2) The greater of:

   a) 50% of W-2 wages of $50,000, or $25,000, or

   b) 25% of $50,000 plus 2.5% of $0, or $12,500

While normally, Jerry's deduction would be limited to $25,000, because Jerry's taxable income is $300,000—which is less than $315,000—the W-2 limitation is disregarded, and Jerry simply takes a deduction equal to 20% of QBI, or $40,000.

Example: Hans and Wendy are married. Wendy has a qualified business that is not a specified service business. For the 2018 tax year, they file a joint return reporting taxable income of $345,000. In that tax year, 20% of the qualified business income from Wendy's business is $15,000. Wendy's share of wages paid by the business in the tax year is $20,000, so 50% of the W-2 wages from the business is $10,000. (For purposes of this example, assume that no qualified property factors into the calculation.) The $5,000 benefit from being able to use the 20% QBI deduction ($15,000) over the 50% of W-2 wages paid ($10,000) is reduced by 30% (($345,000 taxable income − $315,000 threshold amount) / $100,000) or $1,500. Hans and Wendy take a Code Sec. 199A deduction of $13,500 ($15,000 − $1,500).

If taxable income were over $415,000, the QBI deduction would be $10,000 based on the W-2 wages.

If taxable income were under $315,000, the W-2 wage limitation would be ignored and there would be a $15,000 deduction.

Since taxable income falls in the range between $315,000 and $415,000, the $15,000 (20% computed amount) is used and partially phased out. The $15,000 QBI deduction is reduced by 30% ((($345,000 − $315,000)/$100,000) = 30%).

Qualified Trade or Business

A qualified trade or business means any trade or business other than a specified service trade or business and other than the trade or business of being an employee.

A Specified Service Activity normally includes:

- Health,
- Law,
- Accounting,
- Actuarial Science,
- Performing Arts,
- Consulting,
- Athletics,
- Financial Services,
- Brokerage Services, or

- Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

A disallowance of the deduction with respect to specified service trades or businesses is also phased in above the threshold amount ($157,500/$315,000) of taxable income.

Example: Carol, a married taxpayer, has taxable income of $300,000. Her share of the income of the law firm LLC is $200,000, her share of the W-2 wages is $60,000, and her share of the assets of the LLC is $40,000. Even though Carol is a lawyer, she may take the deduction because her taxable income is below $315,000, the start of the phase-in threshold. As a result, Carol can take a deduction of 20% of $200,000, or $40,000. Remember, when taxable income is less than $315,0000, the W-2 limitations do not apply. As a result, Carol is entitled to the full $40,000 deduction.

Example: Theo has taxable income of $187,500, of which $134,000 is attributable to an accounting sole proprietorship (i.e., a specified service business) after paying wages of $67,000 to employees. Because his taxable income is less than the $207,500 threshold for specified service businesses, Theo can claim the Code Sec. 199A deduction, but only for an applicable percentage of his qualified items of income, gain, deduction, or loss, and the W-2 wages, from the accounting business. (For purposes of this example, assume that no qualified property factors into the calculation.) Theo has a 40% applicable percentage (1 − ($187,500 − $157,500)/$50,000 = 40%)). In determining includible qualified business income, Theo takes into account 40% of $134,000, or $53,600. In determining the includible W-2 wages, Theo takes into account 40% of $67,000, or $26,800. Theo calculates the deduction by taking the lesser of: 20% of $53,600 ($10,720), or 50% of $26,800 ($13,400). Theo can take a Code Sec. 199A deduction for $10,720.

The deduction is allowed only for Federal income tax purposes. Does not reduce self-employment income. The deduction does not reduce adjusted gross income. The 20% deduction is not allowed in computing adjusted gross income, and instead is allowed as a deduction reducing taxable income.

Thus, for example, the 20% deduction does not affect limitations based on adjusted gross income. The deduction is available to both non-itemizers and itemizers. The deduction is taken at the top of page 2 of Form 1040.

QBI Loss

If the net amount of qualified income, gain, deduction, and loss is less than zero, the loss is carried over to the next tax year). Any deduction allowed in the next tax year is reduced (but not below zero) by 20% of any carryover qualified business loss.

Example. Larry owns 50% of an S corporation. In 2018, the S corporation allocates a $100,000 loss to Larry. Because Larry materially participates in the S corporation, he can use the $100,000 loss in full to offset his wife's $200,000 of wages. In 2019, the S corporation allocates $200,000 of income to Larry.

While Larry would generally start the process of determining his Section 199A deduction by taking 20% of $200,000, Section 199A(b)(6) provides that in determining Larry's QBI deduction for 2019, the $200,000 of income must be reduced by the $100,000 of loss from 2018. Thus, while Larry will still include the full $200,000 of S corporation income in his taxable income in 2019, his deduction will be limited to $20,000 (20% x $100,000) rather than $40,000 (20% × $200,000).

Example. Judy carries on two qualified business, Alpha LLC and Beta, LLC. Judy has qualified business income of $30,000 from Alpha and a qualified business loss of $70,000 for Beta. Judy cannot claim the Sec. 199A deduction for 2018, but she has a carryover qualified business loss of $40,000 to 2019. In 2019, Judy has qualified business income of $30,000 from Alpha and $60,000 from Beta. To determine the Sec. 199A deduction for 2019, Judy reduces the 20% deductible amount determined for the $90,000 qualified business income from Alpha and Beta by 20% of the $40,000 carryover qualified business loss.

Domestic Business

Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States.

Each Separate Business

It certainly appears that the 20% deduction will be required to be computed with respect to each separate business owned by the individual.

Alternative Minimum Tax

Section 199A(f)(2) provides than when computing alternative minimum taxable income, you determine "qualified business income" without taking into consideration any AMT adjustments or preferences as provided in Section 55–59. QBI is the same for AMT as it is for regular tax, and thus, the 20% deduction is computed the same way. The determination of alternative minimum taxable income starts with taxable income, and the amended Code provides no specific add-back to AMTI for the 20% deduction.

Net Operating Loss

Section 172(d) has been amended to provide that a net operating loss does not include the Section 199A deduction.

Real Estate

Section 199A(c) requires that QBI be earned in a qualified trade or business. The term the tax law does not well define trade or business. In fact, there some different interpretations of what constitutes a trade or business for different purposes of the Code. The highest standard, however, is that of a Section 162 trade or business, and for an activity to achieve this standard, the business must be regular, continuous, and substantial. Over 100 years of judicial precedent has not provided much insight into whether a rental activity rises to the level of a Section

162 trade or business. The determination depends on many factors: how long is the lease? Is the lease gross or triple net? What type of property is being leased?

Example: Sara owns a 50% interest in a commercial rental property through an LLC. Sara's share of the rental income of the LLC is $1,500,000. The LLC pays no W-2 wages, rather, it pays a management fee to an S corporation Sara controls. The management company pays W-2 wages, but also breaks even, passing out no net income to Sara. Sara's share of the total unadjusted basis of the commercial rental property is $10,000,000.

Sara is entitled to a deduction—assuming the rental activities rise to the level of a Section 162 business—equal to the lesser of:

1. 20% of QBI or $1,500,000 ($300,000) or
2. 2.5% of the unadjusted asset basis of $10,000,000 ($250,000).

As a result, Sara is allowed a $250,000 deduction that was very nearly zero before the property addition.

Capital Gains Example: Tony has $100,000 of QBI. In addition, Tony has $200,000 of long-term capital gains, $20,000 of wages, and $50,000 of itemized deduction, for a taxable income of $270,000.

Tony's deduction is limited to the lesser of:

1. 20% of QBI of $100,000, or $20,000, or
2. 20% of ($270,000 – $200,000), or $14,000

Thus, Tony's deduction is limited to $14,000. Because while Tony has taxable income of $270,000—including $100,000 of QBI—$200,000 of that taxable income will be taxed at favorable long-term capital gains rates. Thus, there is only $70,000 to be taxed at ordinary rates, meaning the 20% deduction should be limited to $70,000 of income; after all, you do not want to give a 20% deduction against income that is already taxed at a top rate of 23.8%.

The Deduction Does Not Reduce S Corporation Shareholder Basis

The 20% deduction has no effect on an S shareholder's basis because the deduction is not listed in Sec. 1367(a).

Accuracy-Related Penalty

A taxpayer who claims the Code Sec. 199A deduction may be subject to the 20-percent accuracy-related penalty for a substantial understatement of income tax if the understatement is more than the greater of five percent (not 10 percent) of the tax required to be shown on the return for the tax year, or $5,000. [Code Sec. 6662(d)(1)(C)]

Nonqualified Deferred Compensation

An employee is taxed on compensation as soon as there is no substantial risk of forfeiture regarding that compensation (i.e., receipt of the compensation is not subject to future performance of substantial services.

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A condition shall not be treated as constituting a substantial risk of forfeiture solely because it consists of a covenant not to compete or because the condition relates (nominally or otherwise) to a purpose of the compensation other than the future performance of services—regardless of whether such condition is intended to advance a purpose of the compensation or is solely intended to defer taxation of the compensation.

Certain Self-Created Property

The Act states that gain or loss from the disposition of a self-created patent, invention, model or design (whether or not patented), or secret formula or process is ordinary in character. This would be consistent with the treatment of copyrights under Pre-Act Law. The election to treat musical compositions and copyrights in musical works as a capital asset remains in place.

Sale or Exchange of Patents

Pre-Act Law: Section 1235 provides that a transfer of all substantial rights to a patent, or an undivided interest therein which includes a part of all such right, by a holder shall be considered the sale or exchange of a capital asset held for more than one year.

Under the House bill the special rule treating the transfer of a patent prior to its commercial exploitation as long-term capital gain would be repealed. The Act does not include the provision.

Reforms to Discharge of Certain Student Loan Indebtedness

The Act excludes from taxable income any income resulting from the discharge of student debt because of death or total disability of the student. The Act does not include a provision that would exclude from income repayment of a taxpayer's loans pursuant to the Indian Health Service Loan Repayment Program.

Employer-Provided Housing

Under the House bill the exclusion for housing provided for the convenience of the employer and for employees of educational institutions would be limited to $50,000 ($25,000 for a married individual filing separately) and would phase out for highly compensated individuals (income of $120,000 for 2017, as adjusted for inflation) at a rate of one dollar for every two dollars of adjusted gross income earned by the individual beyond the statutory threshold of being highly compensated. The exclusion also would be limited to one residence. The Act does not include the House provision.

Sale of Principal Residence

Pre-Act Law: Taxpayers can exclude up to $500,000 on the sale of a home, if they have used it as a primary residence for at least two of the last five years.

The House and Senate bills both required a taxpayer would have to own and use a home as the taxpayer's principal residence for five out of the previous eight years to qualify for the exclusion. The exclusion would be phased out by one dollar for every dollar by which a taxpayer's adjusted gross income exceeds

$500,000 ($250,000 for single filers) measured over the average income for taxable and two prior years. Under the Act, no changes are made to the law.

Employee Achievement Awards

The House bill repeals the exclusion for employee achievement awards, so that such awards would constitute taxable compensation to the recipient. The provision also would repeal the restrictions on employer deductions for such awards. The Act does not include employee achievement awards in income.

The Act adds a definition of tangible personal property that may be considered a deductible employee achievement award. It provides that tangible personal property shall not include cash, cash equivalents, gift cards, gift coupons or gift certificated (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or vacations, meals, lodging, tickets to theater or sporting event, stocks, bonds, other securities, and other similar items. No inference is intended that this is a change from Pre-Act Law and guidance.

Education Savings Rules

Elementary and high school expenses of up to $10,000 per year are now qualified expenses for section 529 plans. Apprenticeship program expenses are not included in the Act. The new law expands use of 529 college savings accounts to include K-12 private school tuition.

The House provision provided that an unborn child may be treated as a designated beneficiary or an individual under section 529 plans. An unborn child means a child in utero. A child in utero means a member of the species homo sapiens, at any stage of development, who is carried in the womb. The unborn child provision is not included in Act. The Act does not allow certain home-schooled expenses.

Those expenses are (1) curriculum and curricular materials; (2) books or other instructional materials; (3) online educational materials; (4) tuition for tutoring or educational classes outside of the home (but only if the tutor or instructor is not related to the student); (5) dual enrollment in an institution of higher education; and (6) educational therapies for students with disabilities. Coverdell Educations Savings Accounts were left alone.

Dependent Care Assistance Programs

Pre-Act Law: An exclusion from the gross income of an employee of up to $5,000 annually for employer-provided dependent care assistance.

The House proposed repealing the exclusion. No provision included in Act.

Moving Expense Reimbursement

Pre-Act Law: Qualified moving expense reimbursements are excluded from an employee's gross income.

The exclusion is repealed for qualified moving expense reimbursements except for a member of the Armed Forces of the United States on active duty who moves pursuant to a military order.

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Adoption Assistance Programs

Pre-Act Law: An exclusion from an employee's gross income is allowed for qualified adoption expenses paid or reimbursed by an employer, if such amounts are furnished pursuant to an adoption assistance program.

House proposed repealing the exclusion for adoption assistance programs. Act does not repeal the exclusion.

U.S. Savings Bonds

Pre-Act Law: The interest on certain U.S. savings bonds are not taxed if the proceeds are used for qualified higher education expenses.

The House proposed to eliminate this exception. The Act does not include the House provision.

Tuition Waivers

Pre-Act Law: Employees of education institutions who receive reduced tuition—or a waiver—generally not taxed on that income.

The House proposed to tax the benefit. Tuition reduction not considered income in the Act.

Employer-Paid Tuition

Pre-Act Law: Amount paid by employers for tuition up to $5,250 per year is not taxable income.

The House proposed to tax the benefit. The employer-paid tuition is not considered income in the Act.

Riding Bicycle to Work

Pre-Act Law: You can exclude up to $20 a month from your income for expenses related to regular bicycle commuting if you are not receiving other pretax commuting benefits from your employer.

Bike expenses are no longer excludable.

Private Activity Bonds

Pre-Act Law. Interest on tax-exempt bonds used to fund low-income housing and other projects is exempt from income tax but subject to the alternative minimum tax.

There is no change in the final law.

Exempt Bonds for Professional Stadiums

Pre-Act Law: Professional sports facilities continue to be financed with tax exempt bonds even though privately-owned sports teams are the primary (if not exclusive) users of such facilities.

The House provision provides that the interest on bonds, the proceeds of which are to be used to finance or refinance capital expenditures allocable to a professional sports stadium, is not tax exempt. No provision in the Act.

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Contributions to Capital

The gross income of a corporation would include contributions to its capital, to the extent the amount of money and fair market value of property contributed to the corporation exceeds the fair market value of any stock that is issued in exchange for such money or property. Similar rules would apply to contributions to the capital of any non-corporate entity, such as a partnership. The provision would be effective for contributions made, and transactions entered into, after the date of enactment.

The conference agreement follows the policy of the House bill but takes a different approach. The conference agreement does not repeal the provision of the Internal Revenue Code under which, generally, a corporation's gross income does not include contributions to capital. Rather, it preserves that provision, but provides that the term "contributions to capital" does not include (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such). The conferees intend that Section 118, as modified, continues to apply only to corporations.

Rollover of Publicly-Traded Securities

Pre-Act Law: A corporation or individual may elect to roll over tax-free any capital gain realized on the sale of publicly-traded securities by purchasing an SSBIC (Specialized Small Business Investment Company) within 60 days. Formerly known as Minority Small Business Investment Companies.

The House bill proposes repealing the provision. The Act repeals the provision.

Qualified Equity Grants

New Sec. 83(I) provides tax benefits to employees of certain start-up companies. Generally, an employee may make a special election with respect to qualified stock transferred to them, so that no amount is included in income for the first taxable year in which the right of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. Income taxation can be deferred by the employee until the earlier of a (a) five years, or (b) the occurrence of a specified event, such as the stock of the company being readily tradable on an established securities market, or a revocation of the election. A written plan must provide that at least 80% of the employees of the company are granted stock options or restricted stock units (RSUs) with the same rights and privileges. The 80% eligibility requirement is met only if affected employees (new hires or existing employees) are either granted stock options or RSUs for that year, and not a combination of both. Section 83(b) elections may not be made with respect to RSUs. Excluded employees who are not considered qualified individuals able to make a special election include individuals who first become a 1% owner or one of the four highest compensated officers in a taxable year, or who fell into such a classification in of the 10 preceding taxable years.

Reduction in Minimum Age for Allowable In-Service Distributions

Under the House bill all defined benefit plans as well as State and local government defined contribution plans would be permitted to make in-service distributions beginning at age 59. In-service distributions are distributions while an employee is still working for the employer. The Act does not include the provision.

Hardship Distributions

Pre-Act Law: One requirement of a hardship distribution is that the employee is prohibited from making elective deferrals and employee contributions to the plan and all other plans maintained by the employer for at least six months after receipt of the hardship distribution.

Under the House proposal, the IRS would be required within one year of the date of enactment to change its guidance to allow employees taking hardship distributions to continue making contributions to the plan. The Act does not include the provision.

Hardship Withdrawals

Pre-Act Law: Employers may not allow hardship distributions to include earnings and employer contributions.

Under the proposed law employers may choose to allow hardship distributions to also include account earnings and employer contributions. The Act does not include the provision.

Increase in Repayment Period of Employee Retirement Plan Loans

Pre-Act Law: Employees whose plan terminates or who separates from employment while they have plan loans outstanding have 60 days to contribute the loan balance to an IRA to avoid the loan being taxed as a distribution.

The Act allows employees whose plan terminates or who separate from employment while they have plan loans outstanding would have until the due date for filing their tax return for that year to contribute the loan balance to an IRA to avoid the loan being taxed as a distribution.

Accrual-Method Taxpayer

The act requires accrual-method taxpayers subject to the all-events test to recognize items of gross income for tax purposes in the year in which they recognize the income on their applicable financial statement (or another financial statement under rules to specified by the IRS). The act provides an exception for taxpayers without an applicable or other specified financial statement.

Business Deductions

100% Expensing

Taxpayers can fully and immediately expense 100% of the cost of qualified property acquired and placed in service after September 27, 2017, and before

January 1, 2023, (with an additional year for certain qualified property with a longer production period). The percentage would phase down after 2023.

Also known as bonus depreciation or additional first-year depreciation.

1) The property cannot be acquired from a related party.
2) The first-year bonus depreciation phases down as follows:
    a) 80% for property placed in service after Dec. 31, 2022, and before Jan. 1, 2024.
    b) 60% for property placed in service after Dec. 31, 2023, and before Jan. 1, 2025.
    c) 40% for property placed in service after Dec. 31, 2024, and before Jan. 1, 2026.
    d) 20% for property placed in service after Dec. 31, 2025, and before Jan. 1, 2027.

The provision expands the property that is eligible for this immediate expensing by repealing the requirement that the original use of the property begin with the taxpayer. Instead, the property is eligible for the additional depreciation if it is the taxpayer's first use. Under the provision, qualified property would not include any property used by a regulated public utility company or any property used in a real property trade or business. As a conforming amendment to the repeal of corporate AMT, the election to accelerate AMT credits in lieu of bonus depreciation is repealed.

The Act maintains the section 280F increase amount for $8,000 for passenger automobiles placed in service after December 31, 2017. For passenger automobiles placed in service after December 31, 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is place in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. The limitations are indexed for inflation for passenger automobiles place in service after 2018.

For vehicles weighing less than 6,000 pounds, each year a passenger auto is depreciated, the deduction is limited to the lesser of:

a) The Section 280F limitation, or
b) The depreciation that would have been computed under Section 168.

Example. If bonus depreciation is elected on a new $60,000 auto, the deduction in year 1 would be limited to $18,000. The problems arise in years 2–6 because in those years, the depreciation would be $0. Finally depreciating the entire remaining basis of the car in year 7 under Section 280F's catch-up rule.

Computer Equipment

Pre-Act Law: A special class of depreciable property that is subject to a special set of tax rules if it is used for business no more than 50% of the time. Listed property includes such items as vehicles, computer equipment, and cell phones. Computer equipment is removed from listed property.

1) Such property is not subject to the substantiation requirements that apply to other listed property.
2) Not required to be depreciated using the straight-line method if business use falls below 50%.

Section 179

The small business expensing limitation under section 179 is increased to $1 million and the phase-out amount is increased to $2.5 million. The provision modifies the expensing limitation by indexing both the $1 million and $2.5 million limits for inflation. Indexed after 2018.

The Act expands the definition of:

1) Section 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging; and
2) Qualified real property to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Qualified Improvement Property

The Act, according to the Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466) set as 15-year recovery period for qualified improvement property effective for property placed in service after December 32, 2017. However, the text of the Act inadvertently omits the provision which would have given a 15-year recovery period for qualified improvement property. A technical correction will be needed to create a 15-year recovery period for qualified improvement property and all such property in the absence of such a correction will treated as 39-year nonresidential real property, effective for property placed in service after December 31, 2017.Need a regular depreciation life of 20 years or less to qualify for bonus depreciation.

The property classification for 15-year qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant property are removed. [Code Sec. 168(e)(3)(E)] All improvement which previously qualified for a 15-year recovery period as qualified leasehold improvement property or qualified retail improvement property all within the definition of qualified improvement property and has a 15-year recovery period, effective for property placed in service after December 31, 2017 (assuming a correction is made).

Qualified Restaurant Property

Improvements to a restaurant will only qualify for the 15-year recovery period for qualified improvement property if the improvement is to the interior of the restaurant and does not relate to an enlargement or internal structural framework of the building or an elevator or escalator. External improvements to a restaurant and restaurant buildings which currently qualify as 15-year qualified restaurant property do not meet the definitional requirements of qualified improvement property and are not eligible for the 15-year recovery period. Such property will be depreciated over 39 years, effective for property placed in service after December 31, 2017.

Interest Deduction Limitation

Every business, regardless of its form, is subject to a disallowance of a deduction for net interest expense more than 30% of the business's adjusted taxable income. The net interest expense disallowance is being determined at the tax filer level—for example, at the partnership level instead of the partner level.

Adjusted taxable income is a business's taxable income computed without regard to business interest expense, business interest income, net operating losses, and depreciation, amortization, and depletion.

Any interest amounts disallowed under the provision would be carried forward to the succeeding five taxable years and would be an attribute of the business (as opposed to its owners). Special rules would apply to allow a pass-through entity's unused interest limitation for the taxable year to be used by the pass-through entity's owners and to ensure that net income from pass-through entities would not be double counted at the partner level.

Businesses with average gross receipts of $25 million or less are exempt from the interest limitation rules.

Under new Section 163(j), an entity may elect to avoid the interest limitations rules. The trade-off is that the entity must depreciate its commercial rental buildings over an ADS life. ADS recovery periods are 40 years for nonresidential property, 30 years for residential and 20 years for improvement property. Because ADS depreciation of the qualified improvement property is required, those assets will not be eligible for 100% expensing.

Example. Donner Company has taxable income of $25,000. Included in that amount is $20,000 of interest income, $150,000 of interest expense, $200,000 of depreciation, and $20,000 of amortization. Donner Company computes its "adjusted taxable income" as follows: $25,000 − $20,000 + $150,000 + $200,000 + $20,000 = $375,000. The adjusted taxable income is then multiplied by 30%, yielding a limitation of $112,500. The total limitation is $112,500 plus interest income of $20,000, or $132,500. Donner Company can deduct $132,500 of the $150,000 of interest expense.

Local Lobbying Expenses

Pre-Act Law: For taxpayers with $2,000 or less of in-house expenditures related to lobbying and political activities, a de minimis exception is if permits a deduction.

Deductions for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments) is disallowed. The provision applies to amounts paid or incurred after the date of enactment.

Excessive Compensation

Pre-Act Law: Code Section 162(m) generally limits to $1,000,000 the tax deduction for annual compensation paid to an executive officer of a publicly traded corporation.

The exceptions to the $1 million deduction limitation for commissions and performance-based compensation are repealed. The provision also revises the definition of covered employee to include the chief executive officer, the chief financial officer, and the three other highest paid employees, realigning the definition with current SEC disclosure rules.

Publicly-Held Corporation

A publicly held corporation is any corporation that issued any class of common equity securities required to be registered under Section 12 of the Securities Exchange Act of 1934, as amended A corporation is not considered publicly held if the registration of its equity securities is voluntary.

The provision extends the applicability of Section 162(m) to include all domestic publicly traded corporations and all foreign companies publicly traded through ADRs. The proposed definition may include certain additional corporations that are not publicly traded, such as large private C or S corporations. [Conference Report 115-466]

The Act also requires that if an individual is a covered employee for any tax year (after 2016), that individual will remain a covered employee for all future years. The act exempts from the definition of compensation for purposes of the tax, remuneration paid to licensed medical professionals in exchange for medical services performed. The amendments made by this section shall not apply to remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017, and which was not modified in any material respect on or after such date.

Tax-Exempt Organizations

An excise tax applies to remuneration of highly-compensated exempt organization executives. A tax-exempt organization will be liable within a tax year for a 21% excise tax (equal to the maximum corporate tax rate on income). A covered employee includes any current or former employee of the applicable tax-exempt organization who is one of the five highest compensated employees for the current tax year.

Research and Experimental Expenditures

Pre-Act Law: Taxpayers may elect to deduct currently the amount of certain reasonable research or experimentation expenditures paid or incurred in connection with a trade or business.

The Act requires specified research or experimental expenditures to be capitalized and amortized over a five-year period, effective for amount paid or incurred in tax years beginning after 2021. Specified research and experimental expenditures attributable to research conducted outside the United States would be amortized over a 15-year period.

Entertainment Expenses

Pre-Act Law: No deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement, or recreation (entertainment), unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or (2) a facility (e.g. an airplane) used in connection with such activity. The deduction generally is limited to 50% of the amount otherwise deductible.

In the Act, no deduction is allowed for entertainment, amusement, or recreation activities, facilities, or membership dues relating to such activities or other social purposes.

The 50% limitation under Pre-Act also would apply only to expenses for food or beverages and to qualifying business meals under the provision, with no deduction allowed for other entertainment expenses. The new law also applies the 50% limitation to certain meals provided by an employer that are Pre-Act 100% deductible. Furthermore, no deduction is allowed for reimbursed entertainment expenses paid as part of a reimbursement arrangement that involves a tax-indifferent party such as a foreign person or an entity exempt from tax.

Employee Fringe Benefits

Pre-Act Law: Certain employer-provided fringe benefits are excluded from an employee's gross income and wages for employment tax purposes, including, but not limited to, de minimis fringes, qualified transportation fringes, on-premises athletic facilities, and meals provided for the convenience of the employer.

No deduction is allowed for qualified transportation and parking fringe benefits.

On-Premises Athletic Facility

The Act repeals the deduction for expenses associated with providing employees an on-premises athletic facility; modifies current-law exception to permit deduction only up to the amount properly reported as compensation.

Employer-Provided Meals

The Senate bill disallows an employer's deduction for expenses associated with meals provided for the convenience of the employer on the employer's business premises or provided on or near the employer's business premises through an employer-operated facility that meets certain requirements. The final version of the bill delays this change until tax years starting after 2025.

Fringe Benefits of Tax-Exempt Entities

Under the Act, tax-exempt entities are taxed on the value of providing their employees with transportation fringe benefits, and on-premises gyms and other athletic facilities, by treating the funds used to pay for such benefits as unrelated business taxable income, thus subjecting the values to those employee benefits to a tax equal to the corporate tax rate.

Nondisclosure Agreements

The Act denies a deduction for settlements and attorney fees subject to nondisclosure agreements paid in connection with sexual harassment or sexual abuse. The effective date applies to amounts paid or incurred aster the date of enactment.

Net Operating Losses

Pre-Act: A net operating loss (NOL) generally means the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years. NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.

Final bill limits the net operating loss deduction to 80% of taxable income (as determined without regard to the deduction). Net operating losses can be carried forward indefinitely, but not carried back (except for certain farming losses). The 80% limitation applies to loses arising in tax years beginning after December 31, 2017.

In the case of any net operating loss, specified liability loss, excess interest loss or eligible loss, carrybacks are permitted in a taxpayer year beginning in 2017, if the NOL is not attributable to the increased expensing that is allowed under section 3101 of the 2017 Act (bonus deprecation). A new limitation of $500,000 ($250,000 if single) on active business losses.

Example. For 2018, Rachel has $1.2 million of gross income and $1.6 million of deductions from a manufacturing business that is not a passive activity. Her excess business loss of $150,000 ($1,600,000 – ($1.2000 + $250,000)). Rachel must treat her excess business loss of $150,000 as an NOL carryover to 2019.

For partnerships and S corporations, the limit on excess business losses is applied at the partner or shareholder level. Each partner's distributive share or each S corporation shareholder's pro rata share of items of income, gain, deduction, or loss of the partnership or S corporation is considered by the partner or shareholder in applying the excess business loss rules to the partner's or shareholder's tax year with or within which the partnership's or S corporation's tax year ends. During the period of 2018 through 2025, the limit on excess farm losses of noncorporate taxpayers will not apply.

A House provision would allow NOLs arising in tax years beginning after 2017 and that are carried forward to be increased by an interest factor to preserve its value. The Act does not include the interest factor.

Contingent Lawyer Fees

A House provision denies attorneys an otherwise-allowable deduction for litigation cost paid under arrangements that are primarily on a contingent fee basis until the contingency ends. No provision in the Act.

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VER: [SC_00049-Master:05 Apr 18 02:10][MX-SECNDARY: 25 Jan 18 08:26][TT-: 23 Sep 11 07:01 loc=usa unit=00520-ch0004v6604] 0

Deduction for Living Expenses Incurred by Congressional Members

Pre-Act: A special provision allows members of Congress a deduction of up to $3,000 per year of living expenses incurred while on official business in the District of Columbia. The deduction is no longer allowed after December 22, 2017.

Above-the-Line Deductions

Trade or Business of Being an Employee

Under the proposals, the only above-the-line deductions allowed for expenses attributable to the trade or business of being an employee would be those for reimbursed expenses and certain expenses of members of reserve components of the United States military.

Teacher Deduction

Pre-Act: Eligible educators are elementary or secondary school teachers, instructors, counselors, principals, or aides in a school for at least 900 hours during a school year. An eligible educator may take an above-the-line deduction for ordinary and necessary expenses incurred 1) by reason of participation in professional development courses related to the curriculum or students the educator teaches, or 2) in connection with books, supplies, computer and other equipment, and supplementary materials to be used in the classroom. The deduction may not exceed $250 (for 2017) in expenses and is indexed for inflation.

The House proposed eliminating the deduction. Senate proposed doubling the deduction to $500. The Act keeps the deduction the same.

Performing Artists

Pre-Act Law: Above the line deduction for employee business expenses of artists with adjusted gross income of $16,000 or less.

House proposed eliminating the deduction. The Act keeps the deduction the same.

Public Officials

Pre-Act Law: Certain fee-basis officials can claim their employee business expenses whether or not they itemize their other deductions on Schedule A. Fee-basis officials are persons who are employed by a state or local government and who are paid in whole or in part on a fee basis.

House proposed eliminating the deduction. The Act keeps the deduction the same.

Student Loan Interest

Pre-Act Law: $2,500 above-the-line deduction

House proposed repealing the deduction for student loan interest. The Act has no repeal.

Deduction for Qualified Tuition and Related Expenses

Prior law before 2017: $4,000 above the line deduction.

House proposed to repeal the deduction for qualified tuition and related expenses after 2017. The Act does not include the one-year extension.

Moving Expenses

Pre-Act Law: Individuals are permitted an above-the-line deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work. Such expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's previous residence and the taxpayer's status as a full-time employee in the new location.

The deduction for moving expenses is repealed. However, there is retention of moving expenses for member of Armed Forces.

Medical Savings Accounts

Under the House bill no deduction would be allowed for contributions to an Archer MSA, and employer contributions to an Archer MSA would not be excluded from income. Existing Archer MSA balances, however, could continue to be rolled over on a tax-free basis to an HSA. Final bill does not include House provision.

Alimony Payments

Alimony payments are not deductible by the payor or includible in the income of the payee. The provision is effective for any divorce decree or separation agreement executed after 2018 and to any modification after 2018 of any such instrument executed before such date if expressly provided for by such modification.

Recharacterization of Roth IRA Contributions

Pre-Act Law: If an individual contributes to an IRA (traditional or Roth) for a taxable year, the individual is permitted to recharacterize the contribution as a contribution to the other type of IRA (traditional or Roth) by making a trustee-to-trustee transfer to the other type of IRA before the due date for the individual's income tax return for that year. In the case of a recharacterization, the contribution will be treated as having been made to the transferee IRA (and not the original, transferor IRA) as of the date of the original contribution.

The rule allowing recharacterization of IRA contributions and conversions is repealed. Under the Act recharacterization cannot be used to unwind a Roth conversion, However, recharacterization is still permitted with respect to other contributions.

For example, an individual may contribute for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA.

A Roth IRA conversion made in 2017 may be recharacterized as a contribution to a traditional IRA if the recharacterization is made by October 15, 2018. A Roth IRA conversion made on or after January 1, 2018, cannot be recharacterized. [IRS website under IRA FAQs]

Domestic Production Activities

Pre-Act Law: Section 199 provides a deduction for taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income (determined without regard to the section 199 deduction) for the taxable year.

The deduction of domestic production activities is repealed in the Act.

Whistleblower Awards

Pre-Act Law: The Code provides an above-the-line deduction for attorneys' fees and costs paid by, or on behalf of, the taxpayer in connection with any action involving a claim of unlawful discrimination, certain claims against the Federal government, or a private cause of action under the Medicare Secondary Payer statute.

The Senate bill provides an above-the-line deduction for attorneys' fees and court costs paid in connection with any action involving claims under a state false claims act, the SEC whistleblower program, and the Commodity Futures Trading Commission whistleblower program. The Act does not include the Senate provision.

Itemized Deductions

Medical Expenses

Pre-Act Law: Qualified medical expenses that exceed 10% of the taxpayer's adjusted gross income are deductible.

Final bill keeps the Pre-Act Law except reduces the threshold to 7.5% for 2017 and 2018. The rule limiting the medical expense deduction for AMT purposes to 10% of AGI does not apply to tax years 2017 and 2018.

Home Mortgage Interest

Pre-Act Law: Deductible mortgage is capped at loans of $1,000.000.

Deductible mortgage interest for new purchases of principal residences is capped at loans of $750,000 starting after December 15, 2017. No interest deduction for home equity loans. Home equity loans are not grandfathered in. The interest deduction on second homes is allowed.

State and Local Taxes

Pre-Act Law: Individuals can deduct the higher of state and local income taxes or sales taxes and real property taxes.

Individuals can deduct no more than $10,000 of the higher of (1) state and local income taxes or sales taxes and (2) real property taxes. The limit does not apply to taxes incurred in carrying on a trade or business or otherwise incurred to produce income. Foreign real property taxes, other than those incurred in a trade or business, are not deductible. Prohibits taxpayers from prepaying next year's state and local income taxes to deduct the taxes on the 2017 returns.

The IRS issued a notice on December 27, 2017, that a prepayment of anticipated real property taxes that have not been assessed prior to 2018 are not deductible in 2017. [IR-2017-210]

There is no change to the business interest deduction. Thus, interest is still deductible on Forms 1065 and 1120S and Schedules C, E, or F.

Charitable Contributions

The 50-percent limitation for cash contributions to public charities and certain private foundations is increased to 60 percent. The provision retains the 5-year carryover period to the extent that the contribution amount exceeds 60 percent of the donor's AGI.

College Athletic Event Seating Rights

The special rule that provides a charitable deduction of 80 percent of the amount paid for the right to purchase tickets for athletic events is repealed.

Charitable Mileage Rate

Pre-Act Law: The charitable standard mileage rate is set by statute at 14 cents per mile.

The House bill allows the amount deductible per mile driven in service to a charitable organization be adjustable for inflation. The provision not included in Act.

Personal Casualty Losses

The deduction for personal casualty and theft losses is generally repealed. The deduction of personal casualty losses associated with special disaster relief legislation is not affected. The Act limits taxpayers' casualty loss deductions only for events that the Federal Emergency Management Agency has designated as federal disaster areas.

The uncompensated loss is reduced by $100 per event and 10% of adjusted gross income. Personal casualty losses can be offset personal casualty gains even if the losses are not incurred in a federally declared disaster.

Tax Preparation Fees

An individual is not allowed an itemized deduction for tax preparation expenses.

Trade or Business of Being an Employee

Under the Act a taxpayer is not allowed an itemized deduction for unreimbursed employee business expenses.

Pre-Act Law and IRS guidance provide examples of items that may not be deducted under this provision. This non-exhaustive list includes:

- Business bad debt of an employee;
- Business liability insurance premiums;

- Damages paid to a former employer for breach of an employment contract;
- Depreciation on a computer a taxpayer's employer requires him to use in his work;
- Dues to a chamber of commerce if membership helps the taxpayer perform his job;
- Dues to professional societies;
- Home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work;
- Job search expenses in the taxpayer's present occupation;
- Laboratory breakage fees;
- Legal fees related to the taxpayer's job;
- Licenses and regulatory fees;
- Malpractice insurance premiums;
- Medical examinations required by an employer;
- Occupational taxes;
- Passport fees for a business trip;
- Repayment of an income aid payment received under an employer's plan;
- Research expenses of a college professor;
- Rural mail carriers' vehicle expenses;
- Subscriptions to professional journals and trade magazines related to the taxpayer's work;
- Tools and supplies used in the taxpayer's work;
- Purchase of travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;
- Union dues and expenses;
- Work clothes and uniforms if required and not suitable for everyday use; and
- Work-related education.

2% Miscellaneous Itemized Deductions

Final bill also repeals the deduction for expenses for the production of collection of income. Repeals other miscellaneous itemized deduction currently subject to the two-percent floor.

Such expenses include:

- Repayments of income received under a claim of right (only subject to the two percent floor if less than $3,000);

- Repayments of Social Security benefits; and
- The share of deductible investment expenses from pass-through entities.

Pre-Act Law and IRS guidance provide examples of items that may not be deducted under this provision. This non-exhaustive list includes:

- Appraisal fees for a casualty loss or charitable contribution;
- Casualty and theft losses from property used in performing services as an employee;
- Clerical help and office rent in caring for investments;
- Depreciation on home computers used for investments;
- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust;
- Fees to collect interest and dividends;
- Hobby expenses, but generally not more than hobby income;
- Indirect miscellaneous deductions from pass-through entities;
- Investment fees and expenses;
- Loss on deposits in an insolvent or bankrupt financial institution;
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed;
- Repayments of income;
- Safe deposit box rental fees, except for storing jewelry and other personal effects;
- Service charges on dividend reinvestment plans; and
- Trustee's fees for an IRA, if separately billed and paid.

Limitation of Wagering Losses

All deductions for expenses incurred in carrying out wagering transactions (not just gambling losses) are limited to the extent of wagering winnings.

Deductions Not Subject to the 2% Limit

These expenses are still deductible and include:

- Amortizable premium on taxable bonds.
- Casualty and theft losses from income-producing property.
- Federal estate tax on income in respect of a decedent.
- Gambling losses up to the amount of gambling winnings.
- Impairment-related work expenses of persons with disabilities.
- Loss from other activities from Schedule K-1 (Form 1065-B), box 2.
- Losses from Ponzi-type investment schemes.

- Repayments of more than $3,000 under a claim of right.
- Unrecovered investment in an annuity.

Repeal of Overall Limitation on Itemized Deductions

Pre-Act Law: income above certain limits cause a reduction in the itemized deductions.

The Act repeals the overall limitation on itemized deductions before 2026.

Credits

Child Tax Credit

Pre-Act Law: A $1,000 credit for each child under age 17. The credit begins phasing out for those earning more than $75,000\$110,000. The credit partially refundable to qualified taxpayers who earn more than $3,000.

The credit is doubled to $2,000 and provides it for each child under 17 through 2025. The credit phases out at $200,000 for singles and $400,000 for married. The refundable portion of the credit is $1,400 in 2018. The earned income threshold is $2,500.

Partial Credit

A partial credit of $500 is allowed with respect to each dependent other than a qualifying child. A qualifying child without a social security number qualifies for the family credit. The partial credit is effective for taxable years ending before January 1, 2026. The credit begins to phase out at $200,000 for singles and $400,000 for married. The phaseouts are not indexed for inflation. The partial credit is nonrefundable.

Refundable Credit Program Integrity

A taxpayer is required to provide a work-eligible SSN to claim the child tax credit or the American Opportunity Tax Credit. The IRS is granted math error authority to adjust the returns of taxpayers failing to satisfy the identification requirements. To claim the refundable Earned Income Tax Credit, a taxpayer is required to provide a work-eligible social security number.

Adoption Credit

House proposed to repeal the adoption credit. The Act has no repeal.

Education Credits

The House bill would eliminate the Lifetime Learning Credit and adds a fifth year to the American Opportunity Credit at half the regular amount. The Act makes no changes to the education credits.

Earned Income Credit

House bill required that if the earned income of a taxpayer claimed on a return for purposes of this section is not substantiated by statements or return under sections 6051, 6052, 6041(a) or 6050W with respect to such taxpayer, the

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Secretary may require such taxpayer to provide books and records to substantiate such income, including for preventing fraud. The Act does **not** include the provision.

Prohibited Individuals and the Earned Income Credit

In the House bill individuals prohibited from engaging in employment in U. S. are **not** eligible for the earned income tax credit. Final bill does not include provision.

Claiming All Deductions

House bill clarifies that a taxpayer is required to claim all allowable deductions in computing net earnings from self-employment for EIC purposes. The Act does **not** include provision.

Employer-Provided Child Care Credit

Pre-Act Law: Taxpayers are eligible for a tax credit equal to 25% of qualified expenditures for employee child care and 10% of qualified expenditures for child care resource and referral services.

The House bill proposed repeal of the credit. The Act does **not** repeal the credit.

Rehabilitation Credit

The Act repeals the 10-percent credit for pre-1936 buildings; retains the 20-percent credit for qualified rehabilitation expenditures with respect to a certified historic structure, allowable ratably over a five-year period starting with the year the qualified rehabilitated building is placed in service. The provision applies to amounts paid or incurred after December 31, 2017. A transition rule provides that in the case of qualified rehabilitation expenditures (for a pre-1936 building) with respect to any building owned or leased (as provided under Pre-Act Law) by the taxpayer at all times on and after January 1, 2018, the 24-month period selected by the taxpayer is to begin no later than the end of the 180-day period beginning on the date of the enactment of the Act, and the amendments made by the provision apply to such expenditures paid or incurred after the end of the taxpayer year in which such 24-month period ends.

Work Opportunity Credit

The House bill proposed repeal of the work opportunity tax credit. The Act does **not** repeal the work opportunity credit. The Work Opportunity Credit Expires after 2019.

Unused Business Credits

The general business credit (GBC) consists of various individual tax credits allowed with respect to certain qualified expenditures and activities. In general, the various individual tax credits contain provisions that prohibit "double benefits," either by denying deductions in the case of expenditure-related credits or by requiring income inclusions in the case of activity related credits. Unused credits may be carried back one year and carried forward 20 years. Section 196 allows a deduction to the extent that certain portion of the GBC expire unused after the end of the carry forward period. In general, 100 percent of the unused credit is allowed as a deduction in the taxable year after such credit expired.

The deduction for unused business credits would be repealed by the House and Senate. The Act does not include the provision.

New Markets Tax Credit

Pre-Act Law: Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity (CDE).

Under the House bill no additional new markets tax credits would be allocated after 2017; however, credits that would have already been allocated may be used over the course of up to seven years as contemplated by the credit's multi-year timeline. The Act does not repeal the credit.

Credit for Access for Disabled

Pre-Act Law: Section 44 provides a 50% credit for eligible access expenditures paid or incurred by an eligible small business for the taxable year.

The House bill repeals the credit for expenditures to provide access to disabled individuals. The credit is not repealed in the Act.

Credit for Portion of Employer Social Security Paid on Tips

Pre-Act Law. Certain food or beverage establishments may elect to claim a business tax credit equal to an employer's taxes under the Federal Insurance Contributions Act (FICA) paid on tips I excess of those treated as wages for purposes of meeting the minimum wage requirements of the Fair Labor Standards Act (the FLSA) as in effect on January 1, 2007.

The House bill proposed modifying this credit to reflect the current minimum wage so that it is available with regard to tips reported only above the current minimum wage rather than tips above $5.15 per hour. There is no provision in the Act.

Credit for the Elderly and Permanently Disabled

Pre-Act Law: Certain taxpayers who are over the age of 65 or retired because of permanent and total disability may claim a nonrefundable credit.

The House bill proposed repealing the credit. The Act does not include repeal.

Employer Credit for Paid Family and Medical Leave

The paid family and medical leave credit is an amount equal to the applicable percentage of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave. Applicable percentage means 12.5% increased (but not above 25%) by 0.25% point for each percentage point by the rate of payment exceeds 50%. The amount of family and medical leave that may be considered with respect to any employee for any taxable year shall not exceed 12 weeks. Only available for wages paid in tax years

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beginning after December 31, 2017 and before January 1, 2020. The workers must earn less than $72,000 a year and the leave must cover at least 50% of their wages.

An eligible employee is entitled to FML under the following circumstances, according to the Family and Medical Leave Act:

1) The birth of a child of the employee and to care for such child;
2) The placement of a child for adoption or foster care;
3) A serious health condition of a spouse, child, or parent requiring the employee to care for such person;
4) The employee's serious health condition that makes the employee unable to perform the functions of the employee's position;
5) Any "qualifying exigency" arising out of the fact that the employee's spouse, child, or parent is a military member on covered active duty or call to covered active duty status; or
6) To care for a covered service member with a serious injury or illness.

Credit for Plug-in Electric Drive Motor Vehicles

Pre-Act Law: A credit is available for new four-wheeled vehicles.

The House bill proposed repealing the credit. The Act does not include repeal.

Residential Energy Credit

Pre-Act Law: The provision extends the residential energy efficient property credit with respect to solar qualified property through December 31, 2021. The credit rate for such property is reduced to 26 percent for property placed in service in calendar year 2020 and to 22 percent for property placed in service in calendar year 2021. The credit expired after 2016.

Under the House bill the credit for residential energy efficient property would be extended for all qualified property placed in service prior to 2022, subject to a reduced rate of 26 percent for property placed in service during 2020 and 22 percent of property placed in service during 2021. The provision would be effective for property placed in service after 2016. The Act does not restore the credit.

Enhanced Oil Recovery Credit

Pre-Act Law: Section 43 provides a 15% credit for expenses associated with an enhanced oil recovery (EOR) project.

The House bill proposed repealing the enhanced oil recovery credit. The Act does **not** repeal the credit.

Additional Taxes

Alternative Minimum Tax

The AMT is repealed for corporations.

The Act allows the AMT credit to offset the regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of taxable years beginning 2021) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of minimum tax credit will be allowed in taxable years beginning before 2022.

The Act does not repeal the individual AMT but increases the exemption amounts and the phaseout thresholds. Increase the exemption to $70,300 for singles and $109,400 for joint filers. Increase the phase-out threshold to $500,000 for singles and $1 million for joint filers. The higher limits expire after 2025.

Estate Tax

Pre-Act Law: Applies a 40% levy on estates worth more than $5.6 million for individuals and $11.2 million for couples.

Doubles threshold to $10 million (indexed for inflation after 2011)—$11.2 for singles and $22.4 million for couples. The higher thresholds sunset after 2025. The carryover/stepped up-basis rules governing capital gains realized by donees and beneficiaries remain the same. The continued step-up in asset basis can be more valuable to a taxpayer than repeal of the estate tax.

Affordable Care Act

Pre-Act Law: An individual who fails to buy health insurance must pay penalties of $695 (higher for families) or 2.5 percent of their household income—whichever is higher but capped at the national average cost of the most basic, low-premium, high-deductible plan.

The individual mandate penalty is reduced to $0 beginning in 2019 and is permanent.

Excise Tax on Investment Income

Pre-Act Law: Under Section 4940(a), private foundations that are recognized as exempt from Federal income tax under Section 501(a) (other than exempt operating foundations) are subject to a two-percent excise tax on their net investment income.

Under the House bill certain private colleges and universities would be subject to a 1.4 percent excise tax on net investment income. The provision would only apply to private colleges and universities that have at least 500 students and assets (other than those used directly in carrying out the institution's educational purposes) valued at the close of the preceding tax year of at least $500,000 per full-time student. State colleges and universities would not be subject to the provision. The Act includes the 1.4% tax.

Repatriation

U.S. companies' overseas income held as cash are subject to a 15% rate, while non-cash holdings face an 8% rate.

Self-Employment Taxes

There are no changes to self-employment taxes. S corporation distributed income is not subject to self-employment tax. [Rev. Rul. 59-221]

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Other Provisions

Cash Method of Accounting

The $5 million threshold for corporations and partnerships with a corporate partner to use the cash method of accounting is increased to $35 million and the requirement that such businesses satisfy the requirement for all years is repealed. The increased $25 million threshold is extended to farm corporations and farm partnerships with a corporate partner, as well as family form corporations. Also, under the provision, the average gross receipts test is indexed for inflation. A change to or from the cash method of accounting because of a provision change is treated as a voluntary change in the taxpayer's method of accounting, subject to a Section 481(a) adjustment.

Inventories

Businesses with average gross receipts of $25 million or less are permitted to use the cash method of accounting even if the business has inventories. Under the cash method of accounting, a business may account for inventory as non-incidental materials and supplies. Under the provision, a business with inventories that qualifies for and uses the cash method of accounting can account for its inventories using its method of accounting reflected on its financial statement or its books and records. Non-incidental materials and supplies are deductible in the year they are used or paid, whichever is later.

Uniform Capitalization Rules

Pre-Act Law. The uniform capitalization rules require certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be included in either inventory or capitalized into the basis of such property, as applicable.

Businesses with average gross receipts of $25 million or less are fully exempt from the UNICAP rules. This exemption applies to real and personal property acquired or manufactured by such business.

Completed-Contract Method

The $10 million average gross receipts exception to the percentage-of-completion method increased to $25 million. Businesses that meet the increased average gross receipts test are permitted to use the completed-contract method (or any other permissible exempt contract method).

Like-Kind Exchanges

Pre-Act Law: An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like kind which is to be held for productive use in a trade or business or for investment.

The special rule allowing deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property. However, the provision provides a transition rule to allow like-kind exchanges of personal

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property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017.

Technical Termination of a Partnership

The technical termination rule is repealed. Thus, the partnership is treated as continuing even if more than 50 percent of the total capital and profits interests of the partnership are sold or exchanged, and new elections are not required or permitted.

Due Diligence Requirement for Claiming Head of Household

The Act expands the due diligence requirement for paid preparers to cover determining eligibility for a taxpayer to file as head of household. A penalty of $500 (adjusted for inflation) is imposed for each failure to meet these requirements. Preparers must exercise due diligence in ensuring that clients qualify for the child tax credit, earned income credit, lifetime learning credit, and American Opportunity Tax Credit.

Fines, Penalties, and Other Amounts

Pre-Act Law: The Code denies a deduction for fines or penalties paid to a government for the violation of any law.

The Act denies deductibility for any otherwise deductible amount paid or incurred (whether by suit, agreement, or otherwise) to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law. An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, that are identified in the court order or settlement agreement as restitution, remediation, or required to come into compliance.

In the case of any amount of restitution for failure to pay any tax and assessed as restitution under the Code, such restitution is deductible only to the extent it would have been allowed as a deduction if it had been timely paid. The IRS remains free to challenge the characterization of an amount so identified; however, no deduction is allowed unless the identification is made. Restitution or included remediation of property does not include reimbursement of government investigative or litigation costs.

The provision applies only where a government (or other entity treated in a manner like a government under the provision) is a complainant or investigator with respect to the violation or potential violation of any law. An exception also applies to any amount paid or incurred as taxes due. The provision requires government agencies (or entities treated as such agencies under the provision) to report to the IRS and to the taxpayer the amount of each settlement agreement or order entered into where the aggregate amount required to be paid or incurred to or at the direction of the government is at least $600 (or such other amount as may be specified by the Secretary of the Treasury as necessary to ensure the efficient administration of the Internal Revenue laws).

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The report must separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance. The report must be made at the time the agreement is entered into, as determined by the Secretary of the Treasury.

Churches and Politics

Pre-Act Law: The Johnson Amendment, which has been in place since 1954, prevents religious institutions and nonprofits from involvement in elections via fundraising or endorsements.

Under the House proposal churches are permitted to make statements relating to political campaigns in the ordinary course of religious services and activities. The proposal includes all 501(c)(3) nonprofits, not just churches. Final bill does not include the House proposal.

Qualified Dividends and Capital Gains

The Act does not change the current tax treatment of qualified dividends and capital gains. The new law retains the same breakpoints for application of the capital gains rates as under pre-Act law except the breakpoints will be adjusted for inflation after 2018.

Filing Status	15% Breakpoint	20% Breakpoint
Married Filing Jointly	$77,200	$479,000
Head of Household	$51,700	$452,400
All Other Individual Filers	$38,600	$425,800
Estates and Trusts	$ 2,600	$ 12,700

Dividends Received Deduction

The Act reduces the current 70% dividends-received deduction to 50% and the 80% dividends-received deduction to 65%.

Reporting Stock Transactions

Pre-Act Law: if a taxpayer makes an adequate identification (specific identification) of shares of stock that is sells, the shares of stock treated as sold are the shares that have been identified.

The Senate bill proposed requiring sales of stock would be reported on the First-In, First-Out method. The Act does not include the First-In, First-Out reporting requirement.

Wrongful Levies

The time limit that the IRS must return monetary proceeds from a wrongfully levied sale of property has been extended to two years from the date of levy. The limit for a taxpayer to bring a civil action for wrongful level has been extended to two years from the date of the notice of seizure. Effective after December 22, 2017. See the Bipartisan Budget Act of 2018 article in this issue, also.

Technical Corrections Bill

GOP leaders in Congress have signaled that a technical corrections bill may be necessary in 2018 to "fix" drafting mistakes in H.R. 1. It is unclear at this time how extensive those technical corrections could be or if they could move under the reconciliation process and not require a super-majority for passage in the Senate.

Conclusion

Many different provision of the Internal Revenue Code have been affected by the Tax Cuts and Jobs Act. It will affect different people in different ways, but many people will see a reduction in their tax liability.