December 2017 Client Bulletin

TAX CUTS AND JOBS ACT

Major Highlights

On December 20, 2017, Congress passed The Tax Cuts and Jobs Act and the President is expected to sign the bill sometime next week. This Act's sponsors describe it as containing the most sweeping changes to the Internal Revenue Code since Ronald Reagan signed The Tax Reform Act of 1986. This description is certainly true as to the Act's business provisions. While also important and significant, the Act's individual provisions are in many cases temporary and, as a consequence, may not be as transformative. This Bulletin will focus mainly on the Act's individual tax provisions. However, because the business tax provisions have received so much publicity and are of such great interest to so many, we will begin with a summary of the key elements of both the individual and business tax aspects of the Act.

Individual Provisions

- **Individual rates:** Maintains current seven tax brackets, but temporarily changes most income levels and rates for each one. Reduces top rate and generally provides relief in other brackets. See details below.
- **Standard deduction:** Increased the standard deduction through 2025 for individual taxpayers to $24,000 for married filing jointly, $18,000 for heads of household, and $12,000 for all other individuals.
- **Personal exemptions:** Repealed all personal exemptions through 2025. The withholding rules will be modified to reflect the fact that the individuals can no longer claim personal exemptions.
- **Pass through income deduction:** For tax years after 2017 and before 2026, individuals will be allowed to deduct 20% of "qualified business income" from a partnership, S Corporation, or sole proprietorship, as well as 20% of qualified real estate investment trust (REIT) dividends, qualified cooperative dividends, and qualified publicly traded partnership income. A limitation on the deduction is disallowed for specified service trades or businesses with income above a threshold.
- **Child tax credit:** Increased the amount of the child credit to $2,000 per qualifying child. The maximum refundable amount of the credit is $1,400.
- **Mortgage interest:** Modified the home interest deduction to reduce the limit on acquisition indebtedness to $750,000.
- **Home-equity loans:** Repealed the home equity loan interest deduction through 2025.
- **State and local taxes:** Individuals will be allowed to deduct only up to $10,000 in state and local income and property taxes.
- **Alimony:** For any divorce or separation agreement executed after Dec. 31, 2018, the Act provides that alimony and separate maintenance payments are not deductible by the payer spouse. It repealed the provisions that those payments were includable in income by the payee spouse.
- **Individual shared responsibility payment:** The shared responsibility payment enacted as part of the Affordable Care Act is reduced to zero for months beginning after December 31, 2018.
- **Estate taxes:** The basic estate tax exclusion increases from $5 million to $10 million through 2025.

Business Provisions

- **Corporate tax rate:** Replaced the prior-law graduated corporate tax rate structure, which tax income over $10 million at 35%, with a flat rate of 21%.
- **Corporate AMT:** Repealed the corporate Alternative Minimum Tax.
- **Depreciation:** Extended and modified bonus depreciation, allowing business to immediately deduct 100% of the cost of eligible property in the year it is placed in service, through 2022. The Act also removed the made bonus depreciation available for new property.
- **Sec. 179 expensing:** Increased the maximum amount a taxpayer may expense under Sec. 179 to $1 million and increased the phaseout threshold to $2.5 million. These amounts will be indexed for inflation after 2018.
- **Cash method of accounting:** Expanded the list of taxpayers that are eligible to use the cash method of accounting.
- **Interest deduction limitation:** Under the Act, the deduction for business interest is limited.
- **Net operating losses:** Generally limits the deduction for net operating losses (NOLs) to 80% of taxable income for losses.
- **Taxation of foreign income:** These provisions are highly technical. In general, and most significantly, they exempt U.S. corporations from U.S. taxes on most future foreign profits, ending the present worldwide system of tax profits of all U.S.-based corporations, no matter where they are earned. This would align the U.S. tax code with most other industrialized nations, undercut many offshore tax-dodging strategies and deliver to multinationals a goal they have pursued for years.
- **Repatriation of earnings:** Sets a one-time mandatory tax of 8% of illiquid assets and a 15.5% on cash and cash equivalents for about $2.6 trillion in U.S. business profits now held overseas. This foreign cash pile was created by a rule making foreign profits tax-deferred if they are not brought into the United States, or repatriated. That rule would be rendered obsolete by the new territorial system.

Congress made important but largely temporary changes to individual taxation, many of the most significant of which are explained in the following sections:

Income Tax Rates and Brackets

After much debate Congress did not change the number of brackets. The 2017 top rate is 39.6% which starts with taxable income of $418,400 for single individuals and $470,000 for married filing jointly taxpayers. For 2018, the top marginal rate is 37%. However, the highest marginal rate is effective for taxable income over $500,000 for single taxpayers and $600,000 for married filing jointly taxpayers.

The marginal rates have been cut as well. Taxpayers who typically find themselves in the 25% and 28% marginal rates will see rates reduced to 22% and 24%. Taxpayers having taxable income around $250,000 who file married filing jointly in 2017 are in the 33% marginal tax bracket. For 2018, $250,000 is in the 24% marginal tax bracket.

Itemized Deductions and Standard Deduction

The area of itemized deductions and the standard deduction received much overhaul. To overhaul the tax code, certain provisions require deletion and with that deletion, record keeping requirements and substantiation becomes simpler. Most of these new provisions have a sunset provision (i.e. suspended) ending December 31, 2025 unless otherwise noted. Some changes were mentioned earlier but the following list summarizes most all the changes:

1) The limitation for home acquisition interest is reduced to $750,000.
2) Interest on home equity indebtedness is suspended.
3) State and local taxes and property taxes are aggregated for a total of $10,000.
4) A personal casualty loss is only available resulting from a loss in a federally declared disaster area.
5) The term "losses from wagering transactions" is to include both losses from wagering transactions and other expenses incurred by the individual in connection with the conduct of that individual's gambling activity. This change is to overrule a 2011 Tax Court decision which treated other costs as trade or business deductions.
6) The 50% limit for charitable contributions to public charities would increase to 60% from 50%.
7) The 80% charitable contribution deduction paid for the right to purchase tickets for athletic events is repealed.
8) The contemporaneous written acknowledgement requirement for donations is repealed.
9) Miscellaneous itemized deductions are suspended.
10) Medical expenses will be deductible in the amount exceeding 7.5% of adjusted gross income for 2017 and 2018. In 2019, the threshold increases to 10%.
11) The 3% phase out of itemized deductions is suspended.

Because of these changes, many taxpayers may find themselves not having to complete Schedule A. Congress increased the standard deduction for taxpayers. The following table represents the standard deduction for 2018:

Standard Deduction for 2018

Filing Status	***Amount***
Married Filing Jointly and Surviving Spouse	$ 24,000
Head of Households	$ 18,000
Unmarried Individuals	$ 12,000
Married Individuals Filing Separate Returns	$ 12,000

This increase roughly doubles the 2017 amounts.

Overhaul of Exclusions and Adjustments

In addition to suspending most itemized deductions, Congress eliminated some exclusions and adjustments. The suspension period ends December 31, 2025 unless otherwise noted. The following items that are adjustments to gross income are no longer deductible:

1) Alimony paid effective for divorce decrees or separation agreements executed after 2018 is not deductible (note that alimony would also be excluded from gross income to the payee).
2) The adjustment for moving expenses is suspended except for members of the Armed Forces.

Overhaul of Exclusions and Adjustments (continued)

3) The $250 adjustment for educator expenses is increased to $500.
4) The exclusion for qualified bicycle commuting reimbursements is suspended.
5) The exclusion for qualified moving expense reimbursements is suspended.
6) The exclusion for the gain recognized on the sale of principal residence is only available if the taxpayer has owned the principal residence for at least five of the eight years ending on the date of the exchange.
7) Taxpayers can only use the principal residence exclusion once in a five-year period.

Education Provisions

Many taxpayers take advantage of 529 college savings plans and the three major education credits (Lifetime Learning, American Opportunity, and Hope). While the original version of the House bill made several changes to this area, the Senate bill made fewer changes. Upon passage of the conference bill, the following provisions to education were made:

1) 529 plans can now be used to pay tuition to attend public, private or religious elementary or secondary schools, not to exceed $10,000 annually per student. Consistent with the current tax provision, there is *no* annual limit for tuition and qualified expenses paid from 529 plans for postsecondary education.

2) The discharge of certain student loans is excluded from gross income if the discharge was pursuant to the death or total and permanent disability of the student.

As with most provisions that were in the Senate version of the bill, the second item sunsets at December 31, 2025.

Overhaul to the Child Tax Credit

Credits for family and individuals also received much attention for simplicity and reform. Here are a few items that have been reformed for tax years 2018 through 2025:

1) The child tax credit is $2,000 per qualifying child.
2) The child tax credit is further modified to provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children.
3) The maximum refundable child tax credit is $1,400 per qualifying child.
4) The child tax credit phases out for taxpayers with adjusted gross income in excess of $400,000 (in the case of married taxpayers filing a joint return) and $200,000 (for all others).
5) A taxpayer must include, before the due date for the filing of the return for the taxable year, a social security number for each qualifying child for whom the credit is claimed on the tax return. This requirement does not apply to a non-child dependent for whom the $500 non-refundable credit is claimed.

Passthrough Income Deduction

For tax years after 2017 and before 2026, individuals will be allowed to deduct 20% of "qualified business income" from a partnership, S corporation, or sole proprietorship, as well as 20% of qualified real estate investment trust (REIT) dividends, qualified cooperative dividends, and qualified publicly traded partnership income. (Special rules would apply to specified agricultural or horticultural cooperatives.)

A limitation on the deduction is phased in based on W-2 wages above a threshold amount of taxable income. The deduction is disallowed for specified service trades or businesses with income above a threshold.

"Qualified business income" means the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. They do not include specified investment-related income, deductions, or losses.

"Qualified business income" does not include an S corporation shareholder's reasonable compensation, guaranteed payments, or — to the extent provided in regulations — payments to a partner who is acting in a capacity other than his or her capacity as a partner.

"Specified service trades or businesses" include any trade or business in the fields of accounting, health, law, consulting, athletics, financial services, brokerage services, or any business where the principal asset of the business is the reputation or skill of one or more of its employees.

The exclusion from the definition of a qualified business for specified service trades or businesses phases out for a taxpayer with taxable income in excess of $157,500, or $315,000 in the case of a joint return.

For each qualified trade or business, the taxpayer is allowed to deduct 20% of the qualified business income for that trade or business. Generally, the deduction is limited to 50% of the W-2 wages paid with respect to the business. Alternatively, capital-intensive businesses may get a higher benefit under a rule that takes into consideration 25% of wages paid plus a portion of the business's basis in its tangible assets. However, if the taxpayer's income is below the threshold amount, the deductible amount for each qualified trade or business is equal to 20% of the qualified business income for each respective trade or business.

Individual AMT

Although there was much discussion as to repealing the individual AMT, the final Act retained it with certain modifications, reducing its overall reach. For tax years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount increases to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return) and $70,300 for all other taxpayers (other than estates and trusts). The phaseout thresholds are increased to $1 million for married taxpayers filling a joint return and $500,000 for all other taxpayers (other than estates and trusts). The exemption and threshold amounts will be indexed for inflation. It is important to note that the aforementioned limitation imposed on the deductibility of state and local taxes along with the elimination of personal exemptions will also serve to reduce the number of taxpayers who are subject to the AMT.

This Bulletin contains summary information for readers as to the key elements of the Act. We look forward to providing in-depth guidance as to specific provisions in the future. While there is only one week left to plan tax affairs for 2017, the clear, overall year-end strategy in many cases would be to accelerate deductions and to defer income, where such actions make sense from both a business and a tax perspective. However, even this simple maxim can be complicated and, as always, we suggest discussing any tax planning strategy with your tax advisor prior to executing. In our next Bulletin, we will review in more depth the Business tax provisions of the Act.

Should you have any questions regarding this bulletin, please contact us.

RFC

BLACKSBURG - CHARLOTTESVILLE - FREDERICKSBURG - LOUISA - RICHMOND - STAUNTON

P.O. BOX 6580 CHARLOTTESVILLE, VIRGINIA 22906

E-MAIL: rfc@rfca.com INTERNET: www.rfca.com TELEPHONE: 434-973-8314 FAX: 434-974-7363