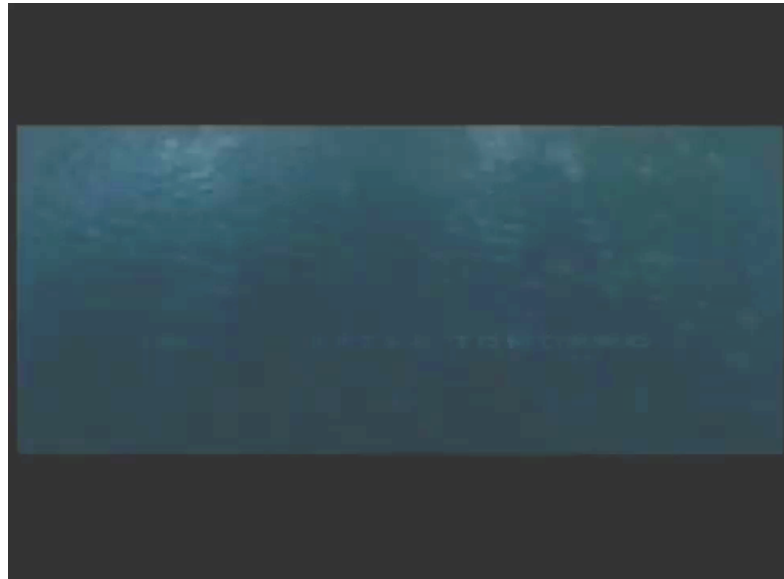


Income Tax Consequences of the Tax Cuts and Jobs Act

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Individual Tax Rates

Ordinary Income

- Rates are lower
 - 2017 – 10%, 15%, 25%, 28%, 33%, 35%, 39.6%
 - New – 10%, 12%, 22%, 24%, 32%, 33%, 37%
- New Thresholds – top marginal rates at:
 - \$500,000 (from \$418,400) for single, HOH
 - \$600,000 (from \$470,700) for MFJ

Other Tax Rates

- Capital Gains – rates unchanged (0, 15%, 20%)
- Kiddie Tax – applies, but simplified
 - Tax rates applicable to trusts and estates apply to child's unearned income
- Individual AMT
 - Individual AMT remains
 - However, AMT exemption and exemption phase-out amounts are increased

Standard Deduction/ Personal Exemption

- Standard Deduction
 - Roughly Doubled:
 - \$24,000 MFJ (from \$12,700)
 - \$18,000 HOH (from \$9,350)
 - \$12,000 All Others (from \$6,350)
- Personal Exemption - Eliminated

Deductions

- Home Mortgage Interest Deduction
 - Limit to \$750,000, “acquisition indebtedness”
 - \$1 Million for debt incurred before 12/15/2017
 - Available for second homes
 - “Acquisition indebtedness” – incurred in acquiring, constructing or substantially improving a qualified residence
- Home Equity Debt
 - no deduction for interest; no grandfathering

Deductions, cont.

- State and Local Tax Deduction
 - Deduction capped at \$10,000
 - Aggregate of state and local real property taxes and income taxes or state and local sales taxes
 - Limitation does not apply to trade or business, production of income
- Miscellaneous Itemized Deductions
 - *E.g.*, home office deductions, license fees, dues
 - Eliminated

Deductions, cont.

- Medical Expense Deduction
 - Expenses that exceed 7.5% of AGI in 2017 and 2018
 - Thereafter, expenses that exceed 10% of AGI
- Casualty and Theft Losses
 - Only if attributable to a federally declared disaster
- Moving Expenses
 - Eliminated, except for certain military personnel
- Charitable Contributions
 - Cash contribution deduction limit 60% AGI
 - College Sports Seating Rights (80%) - eliminated

Deductions, cont.

- Limitation on itemized deductions
 - Eliminated
- Gambling losses and expenses
 - Limited to winnings
- Alimony
 - No longer deductible
 - Beginning in 2019

Credits, ACA

- Child and Family Credits
 - Child credit - increased from \$1,000 to \$2,000 per child (\$1,400 of which is refundable)
 - Phase out starts at AGI over \$400,000 (MFJ), \$200,000 (all others)
 - New \$500 dependent credit (nonrefundable)
- ACA
 - Shared responsibility payment (individual mandate) is zero
 - Beginning in 2019; does not sunset



QBI DEDUCTION

CHOICE OF ENTITY STATISTICS

| | <u>2016</u> (Actual) | <u>2018</u> (Projected) | <u>2021</u> (Projected) | <u>2024</u> (Projected) |
|------------|-------------------------|----------------------------|----------------------------|----------------------------|
| Form 1065 | 4,005,907 | 4,173,700 | 4,414,500 | 4,596,500 |
| Form 1120S | 4,831,588 | 5,007,900 | 5,247,800 | 5,423,100 |
| Form 1120 | 1,807,102 | 1,750,100 | 1,661,100 | 1,576,600 |

Publication 6292 (Rev. 9/2017)

Reductions in Corporate Tax Rates

Effective For All Tax Years Of A C Corporation Beginning After 12/31/17, All Corporate Taxable Income Will Be Subject To Tax At A Flat 21% Rate.

Previously, Under Code § 11(b), Corporations Were Taxed At Graduated Rates from 15% - 35%.

Unlike Most Of The Other Changes Under The Act, This Change is Permanent.

Other Changes Applicable to C Corporations

Reduction In Dividends Received Deductions.

Repeal Of Corporate AMT.

New NOL Limitations

QBI DEDUCTION

For taxable years beginning after December 31, 2017 and before January 1, 2026, taxpayers (including estates and trusts) other than corporations generally may deduct 20% of the QBI of an S corporation, partnership, LLC or a sole proprietorship **allocable** to such shareholder, partner, member or sole proprietor.

QBI DEDUCTION

In order to obtain the full benefit of the deduction, the taxable income of the shareholder, partner, member or sole proprietor must be less than \$157,500 or less than \$315,000 in the case of a married taxpayer filing jointly (the “Threshold Amounts”).

QBI DEDUCTION

A taxpayer receiving the full benefit of the deduction would see a reduction in such taxpayer's top marginal tax rate on QBI to 29.6% (37% top marginal individual tax rate x 20% = 7.4% deduction; 37% - 7.4% = 29.6%).

QBI DEDUCTION

What is QBI?

Foreign Income Excluded

Investment-Related Income Excluded

Reasonable Compensation and Guaranteed
Payments Excluded

QBI DEDUCTION

What Is A Qualified Trade Or Business?

Excludes Specified Service Trade Or Business

Excludes Trade Or Business Of Being An Employee

Definition Of A “Trade or Business”

Section 162

QBI DEDUCTION

Allocable Share

Carryover of Loss to Reduce QBI in Subsequent
Taxable Year

Mechanics of Deduction

Modification of Substantial Understatement
Penalty for 199A: 5% Vs. 10%

QBI DEDUCTION

The deduction is equal to the SUM OF:

The LESSER OF:

1. the “combined qualified business income” of the taxpayer, or
2. 20% of the excess of taxable income over the sum of any net capital gain

~~PLUS the LESSER OF:~~

- ~~1. 20% of qualified cooperative dividends, or~~
- ~~2. taxable income less net capital gain.~~

QBI DEDUCTION

Combined qualified business income is:

THE SUM OF:

1. The LESSER OF:

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

QBI DEDUCTION

b. 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property.

PLUS:

- ~~1. 20% of qualified REIT dividends~~
- ~~2. qualified publicly traded partnership income.~~

QBI DEDUCTION

W-2 Wage and Capital Limitations

What Are W-2 Wages?

Independent Contractors

Management Fees

Qualified Property

Allocable Share

QBI DEDUCTION

Phase In of Wage and Capital Limitations

\$315,000 To \$415,000 Phase-In For Married
Taxpayers Filing Jointly

\$157,500 To \$207,500 Phase-In For All Other
Taxpayers

QBI DEDUCTION

Specified Service Trade or Business

Definition

Consulting Business

Any Trade or Business Where the Principal Business Asset of Such Trade or Business in the Reputation Or Skill of One or More of Its Employees Who Are Owners

QBI DEDUCTION

Engineers and Architects Specifically Excluded

Deduction Still Allowed If Below Threshold amount

Phase Out of Deduction

No Deduction If Over fully Phased In Amount

QBI DEDUCTION

Overall Limitation:

Taxable Income Less Capital Gains

QBI DEDUCTION

Qualified Trade or Business

Versus

Specified Service Trade or Business

QBI DEDUCTION

S Corporations and Unreasonably Low Compensation

Rev. Rul. 74-44, 1974-1 C.B. 287, Rev. Rul. 71-86, 1971-1 C.B. 285 and Rev. Rul. 73-361, 1973-2 C.B. 331.

Radtke v. United States, 895 F.2d 1196 (7th Cir. 1990).

Spicer Accounting, Inc. v. United States, 918 F.2d 90 (9th Cir. 1990).

Esser, PC v. United States, 750 F. Supp. 421(D. Ariz. 1990).

QBI DEDUCTION

Cave v. Commissioner, 476 F. App'x 424 (5th Cir. 2012), aff'g per curiam, T.C. Memo 2011-48.

Watson P.C. v. United States, 668 F.3d 1008 (8th Cir. 2012), aff'g 757 F. Supp. 2d 877 (S.D. Iowa 2010).

Herbert v. Commissioner, T.C. Summ. Op. 2012-124.

Scan McClary Ltd., Inc. v. Commissioner, T.C. Summ. Op. 2013-62.

Glass Blocks Unlimited v. Commissioner, T.C. Memo 2013-180.

IRS Fact Sheet FS-2008-25.

QBI DEDUCTION

High Income Qualified Trade Or Business With No Outside Employees. Assume That A Qualified Trade Or Business Generates \$600,000 Of QBI And That The \$600,000 Is Also A's Taxable Income.

1. Sole Proprietorship. Because A Sole Proprietor Cannot Pay Himself A Salary, And Because A's Taxable Income Is Over The Threshold Amount As Fully Phased-in, The W-2 Limitation Will Apply And A's Deduction Will Be Equal To 50% Of Zero W-2 Wages, Or **Zero**.
2. Partnership. Even If A Pays Himself A Guaranteed Payment Of \$150,000, That Amount Presumably Will Still Not Qualify As W-2 Wages, So Again The Amount Of The Deduction Would Be Equal To 50% Of Zero W-2 Wages, Or **Zero**.

QBI DEDUCTION

3. S Corporation. Since S Corporation Shareholders Are Required To Pay Themselves “Reasonable Compensation”, Assume A Pays Himself \$150,000. In Such Case, A’s Deduction Would Be Equal To The Lesser Of:

(A) 20% Of \$450,000 Of QBI (\$600,000 QBI - \$150,000 Salary) Or \$90,000.

(B) 50% Of \$150,000 W-2 Wages, Or **\$75,000**.

QBI DEDUCTION

Assume That A's Business Only Generates \$300,000 Of QBI And That The \$300,000 Is Also A's Taxable Income.

1. Sole Proprietorship. Because A's Taxable Income Is Below \$315,000, A Will Be Entitled To A Deduction Of 20% Of \$300,000, Or **\$60,000**, Because The Wage Limitations Will Not Apply.
2. Partnership. Assuming No Guaranteed Payments Are Made By The Partnership To A, A Will Likewise Be Entitled To A Deduction Equal To 20% Of \$300,000 Or **\$60,000**.

QBI DEDUCTION

3. S Corporation. A Still Has To Pay Himself “Reasonable Compensation”, So Assume A Pays Himself \$100,000. That Will Reduce A’s Share Of QBI From \$300,000 To \$200,000, So That In This Situation A’s Deduction Would Only Be \$40,000 (20% Of \$200,000).

QBI DEDUCTION

Doubtful that Congress actually intended to have the 199A deduction be different depending on the type of entity the taxpayer is using.

Possible that “reasonable compensation” standard could be applied to partnerships and sole proprietorships the same as for S corporations (with such amounts being treated as W-2 wages).

However, until further guidance is issued in the form of a technical corrections bill or guidance from the IRS, the plain language of new 199A seems to create these anomalous results.

QBI DEDUCTION

Effect of Tax Act on Choice of Entity

Double Tax on C Corporation Earnings

36.8% or 39.8% with Net Investment Income Tax

QBI DEDUCTION

Arguments IRS Can Use Against Corporations
Retaining Earnings:

Reasonable Compensation

Accumulated Earnings Tax

Personal Holding Company Tax

QBI DEDUCTION

Double Tax on Sale of Assets of C Corporation

39.8% Versus 20% Capital Gain Rate on Pass-Throughs

QBI DEDUCTION

Trapped In C Status:

Tax Rates Could Be Increased (Permanent Is NOT Permanent)

Prohibitions on Converting Back To S Status

“Toll” Charges

QBI DEDUCTION

Taxable Liquidation To Convert to LLC

Built-In Gains Tax When Converting From C To S

LIFO Recapture Tax

Tax On Excess Passive Investment Income And
Possible Termination Of S Status

Distribution Rules

Loss of NOLs

Limitation of Business Interest – Code § 163(j)

The deduction for business interest for any tax year cannot exceed the sum of:

- Business interest income;
- 30% of adjusted taxable income; plus
- Floor plan financing interest.

Limitation of Business Interest – Code § 163(j)

Example:

- Adjusted taxable income - \$20,000
- Business interest income - \$2,000
- Business interest expense - \$10,000
- Deduction limited to $\$2,000 + (30\% \times \$20,000 = \$6,000) =$
\$8,000
- The \$2,000 unable to be deducted due to the limitation may be carried forward

Limitation of Business Interest – Code § 163(j)

Limitation does not apply to taxpayers who have average annual gross receipts for the preceding three taxable years less than \$25,000,000.

Limitation of Business Interest – Code § 163(j)

- Definition of Adjusted Taxable Income
- Definition of Business Interest
- Definition of Business Interest Income

Limitation of Business Interest – Code § 163(j)

- Carryforward of disallowed business interest
- Special rule applicable to partnerships

Limitation of Business Interest – Code § 163(j)

Special rules for partnerships:

- **Adjusted taxable income of each partner is determined without regard to such partner's distributive share of any items of income, gain, deduction or loss.**
- Adjusted taxable income of each partner is increased by such partner's distributive share of excess taxable income.
- For these purposes, a partner's distributive share of excess taxable income is determined in the same manner as the partner's distributive share of non-separately stated taxable income or loss of the partnership.

Limitation of Business Interest – Code § 163(j)

Example:

- AB Partnership (“AB”) – partner A corporation (“A”) (50%) and individual B (50%)
- AB has \$1,000 of non-interest income
- AB’s only expense is \$300 of business interest
- AB’s deduction is limited to $(30\% \times \$1,000) = \300
- AB’s business income = \$700
- A’s distributive share = \$350

Limitation of Business Interest – Code § 163(j)

Example:

- A has \$0 taxable income from other operations, but has an additional business interest expense of \$100
- If not for this rule, A's \$350 distributive share would allow A to deduct an additional $(30\% \times \$350) = \105 of business interest
- Thus, A's \$500 share of AB's \$1,000 ATI would create \$255 $(\$150 + \$105)$ of interest deductions (51%)

Limitation of Business Interest – Code § 163(j)

Example:

- This rule provides that A's ATI shall be computed without regard to its \$350 distributive share of AB's non-separately stated income
- Thus, A has ATI of \$0, and its deduction for business interest is limited to \$0 (30% x \$0) as well, resulting in \$100 of business interest deduction disallowance

Limitation of Business Interest – Code § 163(j)

Special rules for partnerships:

- Adjusted taxable income of each partner is determined without regard to such partner's distributive share of any items of income, gain, deduction or loss.
- **Adjusted taxable income of each partner is increased by such partner's distributive share of excess taxable income.**
- **For these purposes, a partner's distributive share of excess taxable income is determined in the same manner as the partner's distributive share of non-separately stated taxable income or loss of the partnership.**

Limitation of Business Interest – Code § 163(j)

Special rules for partnerships:

- Excess taxable income is the amount that bears the same ratio to the partnership's adjusted taxable income as (i) the excess of (1) 30% of the partnership's adjusted taxable income over (2) the amount by which the partnership's business interest, reduced by any floor plan financing interest, exceeds its business interest income of the partnership, bears to (ii) 30% of the partnership's adjusted taxable income

Limitation of Business Interest – Code § 163(j)

Example:

- Same facts as the previous example, except AB has \$250, rather than \$300, of business interest
- Excess of the limit (\$300) over the amount of business interest is \$50 (\$300 - \$250)
- Excess taxable income = $(\$50/\$300) \times \$1,000 = \166.67
- A's distributive share of excess taxable income is \$83.33

Limitation of Business Interest – Code § 163(j)

Example:

- A's deduction for business interest is limited to 30% of the sum of A's ATI plus A's distributable share of the excess taxable income from AB: $30\% \times (\$0 + \$83.33) = \$25$
- Thus, A may deduct \$25 of business interest, resulting in \$75 of business interest deduction disallowance

Limitation of Business Interest – Code § 163(j)

Rules similar to these special partnership rules (other than the partnership carryforward rules) apply to S corporations and their shareholders as well.

Limitation of Business Interest – Code § 163(j)

This limitation is applied at the entity level.

Certain trades or businesses are excluded from the definition of a trade or business for purposes of Code § 163(j).

Modification of Bonus Depreciation – Code § 168(k)

| <u>Placed in service between:</u> | <u>Bonus depreciation:</u> |
|-----------------------------------|----------------------------|
| 9/27/2017 – 12/31/2022 | 100% |
| 1/1/2023 – 12/31/2023 | 80% |
| 1/1/2024 – 12/31/2024 | 60% |
| 1/1/2025 – 12/31/2025 | 40% |
| 1/1/2026 – 12/31/2026 | 20% |

Modification of Bonus Depreciation – Code § 168(k)

Used property (property whose original use does not begin with the taxpayer) may constitute qualified property subject to bonus depreciation if:

- The property was not used by the taxpayer prior to acquisition
- The property was not acquired from certain related persons/component members of a controlled group
- The property was not acquired in a transaction in which the basis of such property was determined by reference to the adjusted basis of such property in the hands of the person from whom it was acquired, or under Code Section 1014

Modification of Expensing – Code § 179

Aggregate cost which can be taken into account under Code § 179 increased from \$500,000 to \$1,000,000.

The \$1,000,000 limitation is reduced, dollar for dollar, by the amount by which the cost of Code § 179 property placed in service during the taxable year exceeds \$2,500,000 (previously \$2,000,000).

Modification of Expensing – Code § 179

The Act also expanded the definition of “qualified real property” under Code Section 179 by replacing (i) qualified leasehold improvement property; (ii) qualified restaurant property; and (iii) qualified retail improvement property with qualified improvement property.

- Qualified real property was also expanded to include (i) roofs; (ii) HVAC property; (iii) fire protection and alarm systems; and (iv) security systems.

Modification of NOL Deductions – Code § 172

NOLs arising in tax years beginning after 12/31/2017 may be carried forward indefinitely but, in most cases, may not be carried back.

The amount of taxable income a taxpayer can offset with an NOL carryforward is limited to 80% of taxable income.

Limitation of Excess Business Losses – Code § 461(l)

Limits “excess business losses” of non-corporate taxpayers.

Applies to taxable years beginning after 12/31/2017 and before 1/1/2026.

Limitation of Excess Business Losses – Code § 461(l)

Excess business losses defined as the excess of:

- The aggregate deductions of the taxpayer for the taxable year which are attributable to trades or businesses of such taxpayer; over
 - The sum of –
 - The aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such trades or businesses; plus
 - \$250,000 (or \$500,000 in the case of taxpayers filing a joint return)

Limitation of Excess Business Losses – Code § 461(l)

- Partnerships and S corporations – applies at the partner / shareholder level
- Losses which are disallowed are treated as NOLs
- Limitation is applied after Code § 469

New Restrictions Imposed on Section 1031 Exchanges

The Act amended Code § 1031 to limit its applicability solely to real property.

Changes Under the Act to Partnerships and LLCs
Treated as Partnerships

- Carried Interests
- Repeal of Technical Termination Rule
- New Rules Applicable to Mandatory Basis Adjustments Upon Sales or Exchanges of Partnership Interests
- New Rule for Pass Through of Partnership Charitable Contribution Deductions
- New Partnership Audit Rules are Now in Effect

Example

Partnership ABC (“ABC”) has three partners – A, B and C

ABC owns two assets:

- Asset #1 – built-in gain of \$1,000,000
- Asset #2 – built-in loss of \$900,000

ABC has no Code § 754 election in effect

ABC’s Partnership Agreement provides if Asset #1 is sold, all of the gain attributable to Asset #1 must be allocated to A, and all profits and losses attributable to the sale of Asset #2 equally allocated among A, B and C

Changes Under the Act to Partnerships and LLCs
Treated as Partnerships

- Carried Interests
- Repeal of Technical Termination Rule
- New Rules Applicable to Mandatory Basis Adjustments Upon Sales or Exchanges of Partnership Interests
- New Rule for Pass Through of Partnership Charitable Contribution Deductions
- New Partnership Audit Rules are Now in Effect

Tax-Exempt Organizations Donors/Effect of Income Tax Changes

- Consider impact of change in standard deduction
- Charitable contribution deduction limitation
 - 60% AGI for cash contributions to public charities
- Athletic seating event rights
 - Partial deduction (80%) is repealed

Tax-Exempt Organizations

- Unrelated Trade or Business Income
 - Separate for each unrelated trade or business
- Contemporaneous Written Acknowledgement
 - From donee, contributions of \$250 or more
 - No reliance on Form 990
- Excise Tax - Large Endowments at Private Schools
 - 1.4% tax on net investment income
- Executive Compensation
 - 21% tax, excess over \$1 Million, top 5 highest paid
 - Exclude medical professionals

Tax-Exempt Organizations, cont.

- Proposals not adopted:
 - Flat 1.4% excise tax on private foundation investment income
 - Johnson Amendment repeal
 - Exception from private foundation excess business holdings tax for wholly-owned philanthropic businesses (“Newman's Own” exception)

Thank you!