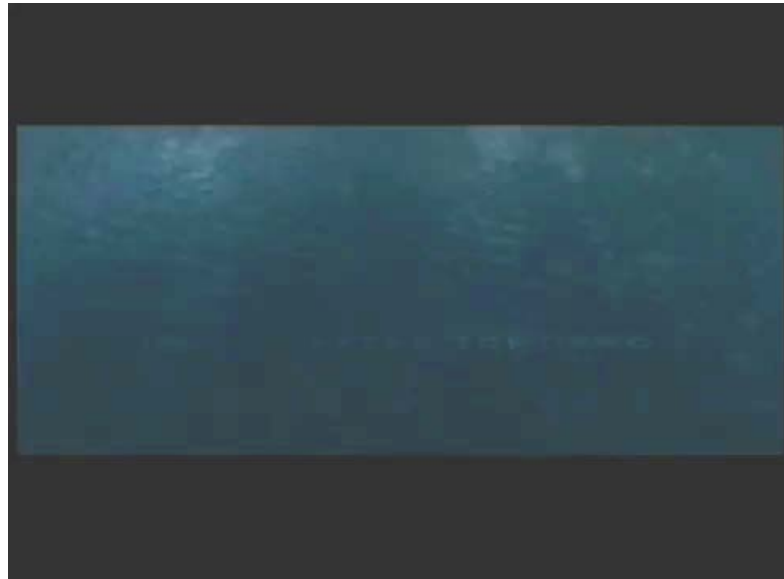


Income Tax Consequences of the Tax Cuts and Jobs Act

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Individual Changes

Tax Rates

Lower Rates

Higher Thresholds

Individual Changes

Other Taxes

Kiddie Tax

AMT

Deductions Exemptions Losses

Standard Deduction

Personal Exemption

State & Local Taxes

Mortgage Interest

Deductions and Exemptions

Miscellaneous Itemized Deductions

Pease Limitations

Alimony

Casualty Losses

Individual Changes

State & Local Taxes

\$10,000 cap

Real property

Income

Sales taxes

Mortgage Interest Deduction

Acquisition Indebtedness - \$750k cap

Home Equity Debt – not allowed

Miscellaneous Itemized Deductions

Home office

Investment expenses

Tax preparation

Unreimbursed work expenses

Individual Changes

Alimony

No longer deductible - 2019

Conference Committee Negotiations



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

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)				

QBI DEDUCTION

For taxable years beginning after December 31, 2017 and before January 1, 2026, taxpayers 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.

Includes Estates and Trusts

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%**.

QBI DEDUCTION

In order to obtain the full benefit of the deduction (and not be subject to the wage and capital limitations), the taxable income of the Owner 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

Example #1: Sole Proprietor (Single-Member LLC) In a Qualified Trade or Business with Taxable Income Less than Threshold Amount. Assume A is the sole owner of a qualified trade or business through a single-member disregarded LLC. The business has no employees and no substantial fixed assets. The QBI from the business is \$200,000 and A's wife has taxable income of \$100,000 so that their combined taxable income is \$300,000.

Because the taxable income of the taxpayer is below the Threshold Amount of \$315,000 for married individuals filing jointly, A's deduction will be equal to \$40,000 (20% x \$200,000 of QBI).

QBI DEDUCTION

If below threshold amounts, get full 20% deduction whether a qualified trade or business or a specified service trade or business.

QBI DEDUCTION

“Overall limitation” applies even if below threshold amounts:

20% of Excess of Taxable Income over Net Capital Gain

QBI DEDUCTION

If above fully phased in thresholds, \$207,500 (\$157,500 + \$50,000) or \$415,000 (\$315,000 + \$100,000) if married filing joint return:

Qualified Trade or Business: Fully subject to Wage & Capital Limits

Specified Service Trade or Business: No Deduction.

QBI DEDUCTION

Phase In of Wage and Capital Limitations For
Qualified Trade or Business

Phase Out of QBI Deduction For Specified Service
Trade or Business

\$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

Wage and Capital Limits:

If Taxpayer is in a qualified trade or business, 20% of QBI deduction limited to:

The greater of:

1. 50% of the W-2 wages with respect to the business, or
2. 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property.

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

Rental Properties

Separate Entities and Grouping

QBI DEDUCTION

What is QBI?

Foreign Income Excluded

Investment-Related Income Excluded

Reasonable Compensation and Guaranteed
Payments Excluded

QBI DEDUCTION

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

What Are W-2 Wages?

Independent Contractors

Management Fees

What is Qualified Property?

Allocable Share

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 Or 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

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 ($\$600,000 \text{ QBI} - \$150,000 \text{ Salary}$) 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

5.5% Florida Income Tax on “C” Corporations

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

5.5% Florida Income Tax on “C” Corporations

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

Cash Method

\$25 million

Corporations

Deductions

Meals & Entertainment

Interest on Business Loans

§ 199 repealed

Lobbying

Deductions

Bonus Depreciation

§ 179 Expensing

§ 280F Auto limits

Interest on Business Loans

§ 163(j)

Capped at

Business interest income

+ 30% of adjusted taxable income

+ Floor plan financing interest

Interest on Business Loans

Example:

- Adjusted taxable income - \$20,000
- Business interest income - \$2,000
- Business interest expense - \$10,000
- Deduction limited to $\$2,000 + (30\% \times \$20,000 = \$6,000) = \$8,000$
- \$2,000 carried forward

Interest on Business Loans

\$25 million gross receipts threshold

Special Partnership Rule

Bonus Depreciation

<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%

§179 Expensing

Increased to \$1 million

Phaseout now \$2.5 million

Qualified Improvement Property

§280F Auto Limits

Increased amounts

Inflation indexed

Net Operating Losses

Carried forward indefinitely

80% limitation

Carryback restricted

Excess Business Losses

Non-corporate taxpayers

Through 2025

\$250k/\$500k limit

Qualified Equity Grants

§83(i) election

Qualified Stock

Qualified Employee

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

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Thank you!