FEDERAL BUZZ HF

Trending: Federal Reform Updates and observations

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Federal Tax Reform is Nearing the Finish Line!

On December 15, 2017, the Tax Cuts and Jobs Act (H.R. 1) conference committee members signed and released a Conference Agreement reconciling the different tax bills passed by the U.S. House and the U.S. Senate. The U.S. Senate passed the bill on December 19, 2017, and the U.S. House passed the final version of the conference committee report on December 20, 2017. President Trump is expected to sign the bill into law.

A summary of some of the key federal tax changes in the Conference Agreement are discussed below. Unless noted below, the federal tax changes will be effective for tax years beginning after 2017.

Business Tax:

- **Corporate Tax Rate Reduction:** The corporate tax rate would be reduced to a flat 21 percent tax rate. The reduced corporate tax rate would be permanent.

- **Corporate Alternative Minimum Tax ("AMT"):** The corporate AMT would be repealed. Taxpayers with AMT credits would be able to use any remaining credits to offset regular tax liabilities in future years.

- **Pass-Through Entity Business Deduction:** A special "business income" tax deduction of 20 percent of certain pass-through entity business income would be created. The term "business income" includes items of income or loss related to a taxpayer's domestic trade or business. The deduction cannot be claimed for amounts that are determined to be reasonable compensation to the owner of the pass-through entity. If the business deduction results in a loss, the loss can be carried over to the next tax year. Trusts and estates are eligible for the deduction. The business deduction is limited for higher income taxpayers. Specifically, the business deduction will be reduced for taxpayers with Form W-2 wages exceeding $157,500 for individuals ($315,000 if married filing jointly). Additionally, pass-through entities operating personal services businesses would not qualify for the pass-through business income deduction unless the taxpayer earned less than $207,500 for single filers and $415,000 for joint filers. The pass-through entity business income deduction is effective for the 2018 through 2025 tax years.

- **Bonus Depreciation:** Bonus depreciation would be increased from 50 percent to 100 percent for "qualified property" placed in service after September 7, 2017 and before 2023. The deduction would be reduced by 20 percentage points starting in 2023 and then reduced by 20 percent for each of the following five years. Thereafter, further Congressional action would be required to extend the bonus depreciation provisions. Certain public utility property and floor plan financing property would not qualify for the deduction. The legislation also increases the depreciation limits for listed property and removes computer or peripheral equipment from the definition.

- **Interest Expense Deduction Limited to 30 percent of Adjusted Taxable Income:** The deduction for interest expense would be disallowed for any amount in excess of 30 percent of the business's adjusted taxable

income from a trade or business ***without*** consideration of any depreciation, amortization, or depletion deductions. Beginning in 2022, the 30 percent limit will be calculated based on adjusted taxable income but ***including*** any depreciation, amortization, and depletion deductions. There is a small business exception if a business has less than $25 million in gross receipts.

- **Net Operating Loss Limits:** The use of an NOL carryover or carryback would be limited to 80 percent of the taxpayer's taxable income. There would be an indefinite NOL carryforward period. Additionally, the NOL carryback would be eliminated except in certain limited instances for certain farming businesses and for property and casualty insurance companies.

- **Research and Experimentation ("R&E"):** Domestic R&E expenses (including software development) would be amortized over a five year period (fifteen years if the activities were conducted outside of the United States). The R&E credit would be preserved without modification.

- **Employer Deductions:** Entertainment activities, membership dues, and commuting expenses would no longer be deductible. Meals and beverages would continue to be 50 percent deductible and would be temporarily expanded (until 2026) to include food and beverages offered for the employer's convenience. Employee awards provided via cash or gift cards would not qualify for a deduction.

- **Like-Kind Exchange Repeal:** The like-kind exchange rules would be modified and limited to real property transactions.

- **Domestic Product Activities Deduction Repeal:** The domestic product activities deduction pursuant to IRC section 199 would be repealed.

- **Partnership Termination Repeal:** The provision providing for a technical termination of a partnership when a significant ownership change occurs would be repealed.

- **Small Business Method of Accounting Election Changes:** Small businesses (with less than twenty five million dollars in average gross receipts) would have greater flexibility to use the cash method of accounting to prepare their tax returns.

- **Tax Credits:** The work opportunity tax credit and new markets tax credit

would be retained, but both credits will expire after 2019.

- **Insurance Company Taxation:** The special rules for the taxation of insurance companies would be modified. For example, the methodology for calculating life insurance reserves and the modification of discounting rules for property and casualty insurers would be significantly changed.

- **Modernization of the International Tax Regime:** The international tax system would be modernized and include a dividend exemption system that will generally exempt 100 percent foreign dividends from foreign corporations received by a U.S. shareholder that owns more than 10 percent of the foreign corporation. Additionally, the Subpart F rules would be modified to tax foreign income under anti-base erosion provisions.

- **Repatriation of Foreign Earnings:** In 2018, the current foreign earnings of U.S. owned foreign subsidiaries would be subject to a one-time repatriation tax. The repatriation tax rate for earnings and profits relating to cash and cash equivalents would be 15.5 percent and the tax rate for the remaining earnings and profits would be reduced to 8 percent. Taxpayers can elect to include the amounts in income over eight years.

- **Base Erosion Anti-Abuse Tax:** A new tax would be imposed on corporations (excluding S corporations, RICs and REITs) with annual gross receipts in excess of $500 million and that have deductible related party expenses in excess of 3 percent or more of the corporation's total deductions. The related party expenses at issue would not include cost of goods sold, certain services, and certain derivative payments. The tax rate would be 5 percent in 2018, and jump to 10 percent until 2026 when the tax rate is increased to 12.5 percent.

Individual Income Tax:

- **Individual Income Tax Changes Expiration Date:** All of the individual income tax provisions included in the Conference Agreement would expire at the end of 2025. Future acts of Congress would be required to extend the provisions or make the provisions permanent.

- **Individual Income Tax Rate Changes:** The individual tax rates and tax brackets would be updated as follows:

Tax Rate	Single	Head of Household	Joint
10%	$0 to $9,525	$0 to $13,600	$0 to $19,050
12%	$9,526 to $38,700	$13,601 to $51,800	$19,051 to $77,400
22%	$38,701 to $82,500	$51,801 to $82,500	$77,401 to $165,000
24%	$82,501 to $157,500	$82,501 to $157,500	$165,001 to $315,000
32%	$157,501 to $200,000	$157,501 to $200,000	$315,001 to $400,000
35%	$200,001 to $500,000	$200,001 to $500,000	$400,001 to $600,000
37%	$500,001 +	$500,001 +	$600,000 +

There would be no changes to the existing investment income tax rates enacted under the Affordable Care Act ("ACA"), the 3.8 percent net investment income tax or the .9 percent additional Medicare tax.

- **Increase in Standard Deduction:** The standard deduction would be increased significantly to $12,000 for single filers and $24,000 for joint filers. The standard deductions would be adjusted for inflation.

- **Changes to Itemized Deductions:** Many of the itemized deductions would be modified from current law or eliminated. The Conference Agreement would allow the mortgage interest deduction (limited to mortgages up to $750,000 until 2025 when the mortgage amount increases to $1,000,000), but not for home equity lines of credit. The state tax deduction (which may include state property taxes and state income or state sales taxes) would be limited to $10,000. The charitable contributions AGI limitation would be increased from 50 percent to 60 percent. Due to the increased limitations placed on these deductions, many taxpayers that historically claimed itemized deductions will now claim the increased standard deduction.

- **Elimination of Personal Exemptions:** Personal exemptions would be repealed.

- **Increase in the Child Tax Credit:** The child tax credit would be increased to $2,000 per child and the phase-out for the child tax credit would be

increased to $200,000 for single filers or $400,000 for joint filers.

- **AMT Repeal:** The AMT would be retained for individuals. However, the exemption amounts would be increased to $70,300 for single filers and $109,400 for joint filers. The phase-out amount of the exemption would be increased to $500,000 for single filers and $1,000,000 for joint filers.

- **Estate Tax Exemption Increase:** The estate tax exemption would be doubled from $5 million dollars to $10 million dollars, indexed for inflation.

- **ACA Individual Mandate:** The ACA individual mandate would be effectively repealed for tax years beginning in 2019 because the penalty for failing to purchase health insurance is reduced to $0.

The federal tax reform process has been a wild ride with significant changes from the U.S. House bill, to the U.S. Senate bill, and finally with the Conference Agreement. If you have any questions on the final federal tax reform legislation, please contact one of the Zaino Hall & Farrin LLC team members.

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