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Highlights of the Tax Cuts and Jobs Act

With the signing of the Tax Cuts and Jobs Act (H.R.1) on December 22, 2017, individuals and businesses will need to determine how they will be affected by the most dramatic changes to the U.S. tax system in over 30 years. The Joint Committee on Taxation projects the cost of the new tax legislation to be almost $1.5 trillion over the next ten years. How the tax legislation affects you or your business depends on your individual set of facts and what actions you take in 2018 and future years. The new tax legislation provides a significant opportunity to generate tax savings. There are however some areas of the legislation where many questions need to be answered and additional guidance will need to be issued.

Many of the changes to the Internal Revenue Code in the bill are temporary. This is true especially with respect to the provisions of the bill impacting individuals. Unless otherwise noted, most provisions are effective for tax years beginning after December 31, 2017. Below is a broad overview of some of the provisions that may significantly impact our clients and friends.

INDIVIDUALS

Tax Rates

The bill includes income ranges for their respective brackets.

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
35%	$400,000 - $600,000	$200,000 - $500,000
37%	Over $600,000	Over $500,000

The bill does not change the current tax treatment of qualified dividends and capital gains.

The bill does not repeal the Affordable Care Act's taxes. Left untouched are the net investment income (NII) tax, the additional Medicare tax, the medical device excise tax, and more.

Standard Deduction

The bill calls for a near doubling of the standard deduction. It increases the standard deduction to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other individuals, indexed for inflation for tax years beginning after 2018. All increases are temporary and would end after December 31, 2025. *The bill eliminates the deduction for personal exemptions and the personal exemption phase-out through 2025. An enhanced child and family tax credit is positioned to make up some of the difference for certain families.*

Deductions and Credits

The bill makes significant changes to some popular individual credits and deductions.

Mortgage interest deduction. The bill limits the mortgage interest deduction to interest on $750,000 of acquisition indebtedness ($375,000 in the case of married taxpayers filing separately). For acquisition indebtedness incurred before December 15, 2017, the bill allows current homeowners to keep the current limitation of $1 million ($500,000 in the case of married taxpayers filing separately).

The Conference agreement also allows taxpayers to continue to include mortgage interest on second homes, but within those lower dollar caps. **However, no interest deduction will be allowed for interest on home equity indebtedness.**

State and local taxes. The bill limits annual itemized deductions for all nonbusiness state and local taxes deductions, including property taxes, to $10,000 ($5,000 for married taxpayer filing a separate return). Sales taxes may be included as an alternative to claiming state and local income taxes.

Miscellaneous itemized deductions. The bill repeals all miscellaneous itemized deductions that are subject to the two-percent floor under current law.

Medical expenses. The bill follows the Senate bill in not only retaining the medical expense deduction, but also temporarily enhancing it. The bill lowers the threshold for the deduction to 7.5 percent of adjusted gross income (AGI) for tax years 2017 and 2018.

Family Incentives

The bill temporarily increases the current child tax credit from $1,000 to $2,000 per qualifying child. Up to $1,400 of that amount would be refundable. The bill also raises the adjusted gross income phaseout thresholds, starting at adjusted gross income of $400,000 for joint filers ($200,000 for all others).

The child tax credit is further modified to provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children.

Alimony

The bill repeals the deduction for alimony payments and their inclusion in the income of the recipient. *To give taxpayers time to adjust to this new balance in assessing benefits and burdens, the new rules will apply only to divorce or separation instruments executed after December 31, 2018.*

Retirement

The bill generally retains the current rules for 401(k) and other retirement plans. However, the bill would repeal the rule allowing taxpayers to recharacterize Roth IRA contributions as traditional IRA contributions to unwind a Roth conversion. Rules for hardship distributions would be modified, among other changes.

Federal Estate Tax

The bill follows the Senate bill in not repealing the estate tax, but rather doubling the estate and gift tax exclusion amount for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026. The generation-skipping transfer (GST) tax exemption is also doubled.

<u>The current maximum federal estate tax rate is 40 percent with an inflation-adjusted $5 million exclusion ($5.49 million in 2017), which married couples can combine for a $10 million exclusion ($10.98 million in 2017).</u> **The new exclusion amounts will now allow married couples to exempt up to $22 million for 2018 (after**

adjustment for inflation) from any estate or gift tax. Heirs, however, will continue to receive a "stepped-up, date of death" basis for inherited assets for purposes of any subsequent sale.

Alternative Minimum Tax

The bill retains the alternative minimum tax (AMT) for individuals with modifications. The bill would temporarily increase (through 2025) the exemption amount to $109,400 for joint filers ($70,300 for others, except trusts and estates). It would also raise the exemption phase- out levels so that the AMT would apply to an income level of $1 million for joint filers ($500,000 for others).

Affordable Care Act

The bill repeals the Affordable Care Act (ACA) individual shared responsibility requirement, making the payment amount $0. This change would be effective for penalties assessed after 2018.

Carried Interest

Under the bill, the holding period for long-term capital gains is increased to three years with respect to certain partnership interests transferred in connection with the performance of services.

BUSINESSES

Corporate Taxes

The bill calls for a 21-percent corporate tax rate beginning in 2018. The bill makes the new rate permanent.

Under the bill, the 80-percent and 70-percent dividends received deductions under current law are reduced to 65-percent and 50-percent, respectively. The bill also repeals the AMT on corporations.

Bonus Depreciation

The bill increases the 50-percent "bonus depreciation" allowance to 100 percent for property placed in service after September 27, 2017. A 20-percent phase-down schedule would then kick in. It also removes the requirement that the original use of qualified property must commence with the taxpayer, thus allowing bonus depreciation on the purchase of used property.

Vehicle Depreciation

The bill would raise the cap placed on depreciation write-offs of business-use vehicles. The new caps would be $10,000 for the first year a vehicle is placed in service; $16,000 for the second year, $9,600 for the third year (up from $3,050); and $5,760 for each subsequent year (up from $1,875) until costs are fully recovered. The new, higher limits apply to vehicles placed in service after December 31, 2017.

Section 179 Expensing

The bill would also enhance Code Sec. 179 expensing. The bill sets the Code Sec. 179 dollar limitation at $1 million and the investment limitation at $2.5 million.

Deductions and Credits

Numerous business tax preferences would be eliminated under the bill. These include the Code Sec. 199 domestic production activities deduction, non-real property like-kind exchanges, and more. Additionally, the rules for business meals would be revised, as would the rules for the rehabilitation credit.

The bill leaves the research and development credit in place, but requires five-year amortization of research and development expenditures. The bill also creates a temporary credit for employers paying employees who are on family and medical leave.

Interest Deductions

The bill generally caps the deduction for net interest expenses at 30 percent of adjusted taxable income, among other criteria. Exceptions would exist for small businesses, including an exemption for businesses with average gross receipts of $25 million or less.

Pass-Through Businesses

The bill generally follows the Senate's approach to the tax treatment of pass-through income, but with some changes, including a reduction in the percentage of the deduction allowable under the provision to 20 percent, a reduction in the threshold amount above which both the limitation on specified service businesses and the wage limit are phased in, and a modification in the wage limit applicable to taxpayers with taxable income above certain threshold amounts.

The bill proposes rules that would prevent pass-through owners—particularly service providers such as accountants, doctors, lawyers, etc.—from converting their compensation income taxed at higher rates into profits taxed at the lower rate.

Net Operating Losses

The bill modifies current rules for net operating losses (NOLs). Generally, NOLs would be limited to 80 percent of taxable income for losses arising in tax years beginning after December 31, 2017. The bill also denies the carryback for NOLs in most cases while providing for an indefinite carryforward, subject to the percentage limitation.

INTERNATIONAL

The bill follows the lead of both the House and Senate bills in moving the United States to a territorial system. The bill would create a dividend-exemption system for taxing U.S. corporations on the foreign earnings of their foreign subsidiaries when the earnings are distributed.

Repatriation

A portion of deferred overseas-held earnings and profits (E&P) of subsidiaries would be taxed at a reduced rate of 15.5 percent for cash assets and 8 percent for illiquid assets. Foreign tax credit carryforwards would be fully available and foreign tax credits triggered by the deemed repatriation would be partially available to offset the U.S. tax.

The lower corporate tax rate may also provide an incentive for businesses to not shift operations overseas in the future.

The above information is general in nature and should not be relied upon for any specific tax implication or investment decision. Actual results may differ, and readers are cautioned not to place reliance on these general observations. Consult with your adviser or counsel before undertaking any specific action.