CORPORATE, TAX & TRANSACTIONAL ALERT

1/9/2018

New Tax Changes: The Tax Cuts and Jobs Act

By John B. Waters

The Tax Cuts and Jobs Act ("Act") (P.L. 115-97) signed into law by President Trump on December 22, 2017 and effective for tax years starting January 1, 2018 reflects a compromise between the House and Senate Bills as originally proposed. The following is a summary of key changes. Note that many of the changes in the Act relating to individuals will expire for tax years after 2025.

Income Tax Changes

Single Corporate Income Tax Rate

The Act eliminates the graduated corporate rates and replaces them with a single 21% rate. Under prior law, professional service corporations were taxed at a flat 35% rate - which was the highest rate. Under the Act, they are taxed at the same 21% rate as other corporations.

Repeal of Corporate Alternative Minimum Tax

The Act repeals the corporate Alternative Minimum Tax.

Individual Income Tax Rates

The Act retains seven income tax brackets, but generally lowers the tax rates. The following comparison between what 2018 rates would have been under prior law to what they are under the new Act is illustrative:

	2018 Rates Under Prior Law		2018 Rates Under The New Act	
Single Filer	10%	$0-$9,525	10%	$0-$9,525
	15%	$9,526-$38,700	12%	$9,526-$38,700
	25%	$38,701-$93,700	22%	$38,701-$82,500
	28%	$93,701-$195,450	24%	$82,501-$157,500
	33%	$195,451-$424,950	32%	$157,501-$200,000
	35%	$424,951-$426,700	35%	$200,001-$500,000
	39.6%	$426,701 or more	37%	$501,000 or more
Married Couple	10%	$0-$19,050	10%	$0-$19,050
	15%	$19,051-$77,400	12%	$19,051-$77,400
	25%	$77,401-$156,150	22%	$77,401-$165,000
	28%	$156,151-$237,950	24%	$165,001-$315,000
	33%	$237,951-$424,950	32%	$315,001-$400,000
	35%	$424,951-$480,050	35%	$400,001-$600,000
	39.6%	$480,051 or more	37%	$600,001 or more

Kiddie Tax Increase

Under prior law, the unearned income of a child under the age of 19 (or college student under the age of 24) was taxed at the rates applicable to the child's parents. The Act provides that such income will be taxed at the same rates as the income of trusts and estates (which for a given level of income are typically higher than the corresponding individual rate would be for such level of income).

Retention of Alternative Minimum Tax for Individuals

The Act retains the Alternative Minimum Tax for individuals, but increases the exemption amounts from $86,200 to $109,400 for joint filers and from $55,400 to $70,300 for single filers.

Repeal of The Individual Mandate

The Act eliminates the penalty under the Affordable Care Act for individuals who do not maintain health insurance coverage.

Estate and Gift Tax Changes

The Act doubles the amount of property exempt from gift and estate tax. For 2018 that increase is from $5.6 million to $11.2 million for individuals ($11.2 million to $22.4 million for married couples) and is indexed for inflation.

Individual Tax Deductions/Credits are Increased, Decreased, or Eliminated

Standard Deduction Almost Doubled

The Act almost doubles the standard deduction for joint and single filers as follows.

2018 Standard Deduction under Prior Law		2018 Standard Deduction under New Act	
Single filer	$6,500	Single filer	$12,000
Joint filer	$13,000	Joint filer	$24,000

Child Tax Credit Doubled

The Act increases the child tax credit from $1,000 per child to $2,000 per child. Additionally, the income levels over which the child tax credit was phased out have been increased to $400,000 for married taxpayers and $200,000 for single taxpayers.

Personal Exemption Eliminated

Under prior law, a couple would have received a personal exemption of $4,150 in 2018 for each spouse and dependent. The Act eliminates the personal exemption.

Charitable Deduction Limit Increased

Under the Act, a donor may deduct charitable contributions to public charities up to 60% of their contribution base, up from 50% under prior law.

State and Local Tax Deduction Limited to $10,000

The Act limits the deduction for State and Local Taxes (SALT) to $10,000.

Deduction for Interest on Home Equity Loans Eliminated and Mortgage Interest Deduction Modified

Under prior law, couples who purchased a house could deduct interest payments on their mortgage up to the first $1 million of indebtedness and could deduct interest on up to $100,000 on home equity loans. The Act terminates the interest deduction on home equity loans, and decreases the amount eligible for acquisition interest deductions to $750,000 for married filers ($375,000 for single filers). Interest on acquisition indebtedness held as of December 15, 2017, is not subject to the limitations.

Certain Commonly Used Deductions Eliminated Under the Act

The Act eliminates the following commonly used deductions: (1) casualty and theft losses; (2) moving expenses; (3) alimony; and (4) miscellaneous itemized deductions such as unreimbursed employee business expenses.

Business Tax Deductions/Credits are Increased, Decreased, or Eliminated

20% Deduction For Certain Pass-Through Income

Under the Act, business owners who receive “qualified business income” from a flow-through entity such as a partnership, S corporation or sole proprietorship may deduct up to 20% of such income, subject to certain limitations. Qualified business income (QBI) is income derived from a U.S. trade or business, other than investment type income and income paid to the owner as wages or for services to a partnership. The ability to use the deduction is subject to limits based on the owner’s taxable income, whether the income is derived from certain services (i.e., the fields of health, law, consulting, athletics, financial or brokerage services, etc.), the amount of wages paid by the business and amount of depreciable assets used in the business. If the owner’s taxable income exceeds a threshold ($315,000 - $415,000 for joint filers and $157,500 - $207,500 for single filers), then their share of income from such service businesses is partially or wholly excluded from their QBI in figuring their deduction. In addition, if the owner’s taxable income exceeds the thresholds described above, their deduction is further limited based on the business’ wages paid and depreciable assets.

Increased Expensing for Equipment

Under prior law, a business could take up to 50% bonus depreciation on certain property placed in service during the year. The Act increases such first-year bonus depreciation percentage to 100% through January 1, 2023. That percentage is phased-down ratably for property placed in service between 2023 and 2026. The Act also expands Code Section 179 expensing of depreciable assets by increasing the $500,000 expensing limit to $1,000,000 and increases the $2,000,000 limit for property placed in service (over which the expensing limit is reduced) to $2,500,000 of property placed in service. The Act increases the annual depreciation limits for business use of passenger automobiles and removes computers and peripheral equipment from the definition of listed property.

Changes to Net Operating Loss Rules

The Act allows for perpetual carryforward of net-operating losses, but generally eliminates carrybacks other than from the business of farming. However, the maximum amount of income for a year that can be offset by a net-operating loss is limited to 80% of such income.

Repeal of Section 199 Deduction for Domestic Production Activities

The Act repeals the deduction under Code Section 199 for income attributable to domestic production activities.

Business Interest Deduction Limited

Under the Act, the deduction of interest by a business will be limited to 30% of its adjusted taxable income (computed with certain adjustments). Any unused interest expense deduction is carried over to the succeeding year as if it were interest paid in that year.

Elimination of Employer Deduction for Entertainment and Certain Other Fringe Benefits

The Act eliminates the employer's deduction for entertainment expenses and qualified transportation fringe benefits (e.g., parking, transit passes).

$1 Million Dollar Limit for Compensation Paid To Covered Employees Now Includes Commissions and Performance Based Compensation

Under prior law, commissions and performance-based compensation were excluded from the $1 million deduction limit for compensation paid to a covered employee of a public company. The Act eliminates that exclusion now making such compensation subject to the $1 million deduction limit.

Credit For Employers Who Provide Paid Family Medical Leave

Subject to limitations, the Act allows an employer a credit of between 12.5% to 25% of compensation paid to employees while on family and medical leave.

Foreign Tax Changes

Change to Territorial Tax Regime

Currently, U.S. corporations are taxed on their income wherever earned. The Act implements a change to a territorial based system.

Deemed Repatriation Tax on Undistributed Foreign Earnings

Under prior law, certain foreign earnings of non-U.S. based corporations with U.S.-corporation shareholders were not taxed in the U.S. until those foreign earnings were distributed to their U.S. shareholder. As part of the switch to a territorial regime, the Act imposes a deemed tax on those accumulated untaxed earnings at 15.5% on cash and 8% on illiquid assets.

Change in Foreign Partner Taxation and Required Withholding

The Act overrules a recent Tax Court case by providing that if a nonresident alien individual or foreign corporation sells their interest in a U.S. partnership, the sale of that interest is considered U.S. source income to the extent of the partner's share of U.S. source income had the partnership sold its assets prior to such sale. The Act also requires the purchaser of a partnership interest to withhold 10% of the amount realized on the sale unless the seller certifies it is not a nonresident alien individual or foreign corporation.

Exempt Organization Tax Changes

21% Tax Imposed on Exempt Organizations That Pay Compensation in Excess of $1 Million

Under the Act, exempt organizations that pay "covered employees" more than $1 million during the tax year or an excess parachute payment during the year are subject to a 21% corporate tax on such excess.

A covered employee means a current or former employee who is (or was) one of the five highest paid employees of the organization during the relevant tax year or any prior tax year after 2016.

School Endowment Tax Created

The Act taxes university endowment income at 1.4%. This change applies to schools with assets greater than $500,000 per student. Certain small schools are specifically exempted from the tax.

Unrelated Business Taxable Income Determined on an Activity-By-Activity Basis

Under prior law, exempt organizations that engaged in activities unrelated to their exemption would compute their unrelated business taxable income from those activities on an entity-wide basis; thus, offsetting losses from one activity against income from another. The Act requires that such income now be determined on an activity-by-activity basis.

Repeal of Like-Kind Exchanges for Personal Property

The Act retains the tax exemption for like-kind exchanges of real property, but eliminates the tax-exemption for like-kind exchanges of personal property.

Contributions to Corporations by Governments or Civic Groups are now Taxable

Under the Act, contributions to a corporation by a governmental entity or civic group are considered taxable income to the corporation. Prior law did not treat such contributions as income.

Retained Provisions

Finally, among other things, pre-tax contributions to 401(k) plans, tax deferral associated with 401(k) investments and the medical expense deduction have been retained.

Roetzel & Andress has broad tax experience working on behalf of businesses. Please do not hesitate to reach out to us with any questions regarding how these tax changes could affect you and your business.

Author
John B. Waters
jwaters@ralaw.com

Manager
Christopher P. Reuscher
creuscher@ralaw.com

Additional contacts
Diana M. Feitl
dfeitl@ralaw.com

Cassandra Manna
cmanna@ralaw.com