Samet & Company
Tax Cuts and Jobs Act Update

Introduction

On December 22, 2017, the Tax Cuts and Jobs Act (TCJA) was signed into law amending the Internal Revenue Code of 1986. The TCJA provides simplification in some areas of the tax code by eliminating certain provisions, but there are many areas with added complexities.

The reporting from traditional and social media sources has many individual taxpayers concerned that the elimination of certain itemized deductions and exemptions will result in them paying a higher tax under the new 2018 law. However, the loss of these deductions must also be viewed in combination with the reduced individual tax rates and expanded brackets. Samet looked at a number of hypothetical scenarios comparing the outcomes under the current and new tax laws and in most cases, the taxpayers' tax liability was lower under the new law.

Businesses are also impacted by many of the changes in the TCJA. The new 21% corporate tax rate has been the most widely publicized. However, it is important to note that this new rate only impacts the 1.7 million C Corporations in the United States. More importantly, the nearly 30 million S Corporations, Limited Liability Companies, Limited Partnerships and Sole Proprietors can potentially benefit from the new 20% pass through deduction.

The following highlighted provisions are some of the key changes resulting from the passage of the TCJA. These changes will primarily be effective starting for the 2018 tax year, and could provide many opportunities to minimize your tax liability going forward.

Overview of Provisions of the TCJA Affecting Individuals

Tax Rates

The new law imposes a new tax rate structure with seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top rate was reduced from 39.6% to 37% and applies to taxable income above $500,000 for single taxpayers, and $600,000 for married couples filing jointly. The rates applicable to net capital gains and qualified dividends were not changed.

Exemptions

The new law suspends the deduction for personal exemptions. Thus, starting in 2018, taxpayers can no longer claim personal or dependency exemptions.

Itemized Deductions

State and local taxes

The itemized deduction for state and local income and property taxes is limited to a total of $10,000 starting in 2018.

Mortgage interest

Under the new law, mortgage interest on loans used to acquire a principal residence and a second home is only deductible on debt up to $750,000 (down from $1 million), starting with loans taken out in 2018. And there is no longer any deduction for interest on home equity loans, regardless of when the debt was incurred. There appears to be an argument, to the extent home equity borrowings qualify as acquisition indebtedness, the interest may still be deductible.

Charitable contributions

Under the new law, the reduction of certain itemized deductions, combined with the higher standard deduction, can result in some or all charitable contributions no longer creating a tax benefit.

Miscellaneous itemized deductions

There is no longer a deduction for miscellaneous itemized deductions which were formerly deductible to the extent they exceeded 2 percent of adjusted gross income. This category included items such as tax preparation costs, investment expenses, union dues, and unreimbursed employee expenses.

Casualty and theft losses

The itemized deduction for casualty and theft losses has been suspended except for losses incurred in a federally declared disaster.

Overall limitation on itemized deductions

The new law suspends the overall limitation on itemized deductions that formerly applied to taxpayers whose adjusted gross income exceeded specified thresholds.

Overview of Provisions of the TCJA Affecting Individuals

Standard Deduction

The new law increases the standard deduction to $24,000 for joint filers, $18,000 for heads of household, and $12,000 for singles and married taxpayers filing separately. Given the limitations to itemized deductions discussed above, a significant number of taxpayers may no longer be itemizing deductions.

New deduction for "qualified business income"

Starting in 2018, taxpayers are allowed a deduction equal to 20 percent of "qualified business income," from certain partnerships, S corporations, LLCs, and sole proprietorships. Importantly, qualified business income does not include owner W-2 income or partner's guaranteed payments. For taxpayers with taxable income above $157,500 ($315,000 for joint filers), (1) phaseout limitations based on W-2 wages paid by the business and depreciable tangible property used in the business are phased in, and (2) income from the following trades or businesses is phased out: health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners.

Other Items

Moving expense

The deduction for job-related moving expenses has been eliminated, except for certain military personnel. The exclusion for moving expense reimbursements has also been suspended.

Alimony

For post-2018 divorce decrees and separation agreements, alimony will not be deductible by the paying spouse and will not be taxable to the receiving spouse.

Health care "individual mandate"

Starting in 2019, there is no longer a penalty for individuals who fail to obtain minimum essential health coverage.

Alternative minimum tax (AMT) exemption

At long last, the number of taxpayers who will be caught in the AMT has been reduced dramatically. The exemption has been increased to $109,400 for joint filers ($54,700 for married taxpayers filing separately), and $70,300 for unmarried taxpayers. The exemption is phased out for taxpayers with alternative minimum taxable income over $1 million for joint filers, and over $500,000 for all others. Using 2016 data, the Tax Foundation noted there were 5.25 million taxpayers in the AMT. For 2018, they project only 200,000 taxpayers will be subject to the AMT.

Estate and gift tax exemption

Effective for decedents dying, and gifts made, in 2018, the estate and gift tax exemption has been increased to roughly $11.2 million ($22.4 million for married couples).

Overview of Provisions of the TCJA Affecting Businesses

Corporate Tax Rates

The passage of the TCJA reduces the C Corp tax rate to a flat 21% effective for years beginning after 12/31/17. For fiscal year corporations, code section 15 allows for the application of an alternative way to calculate the tax resulting in a "blended" rate. The Corporate AMT has been repealed under the new law.

Depreciation

The new law increased the limits for bonus depreciation under code sections 168 and 179. Additional first year bonus depreciation of 100% is now allowed for property acquired after 9/27/17. The new provision allows for the 100% bonus depreciation on new and used qualifying property. The allowable first year deduction phases down for years after 2022.

The allowable amount of bonus depreciation under code section 179 has increased to $1 million and the phaseout threshold has been increased to $2.5 million. The section 179 definition has been expanded to include personal property connected with lodging for residential rental property. In addition, improvement to nonresidential real property was expanded to include roofs, HVAC, fire alarm systems and security systems.

Limitations on Interest Deductions

The new law places limits on the deduction for interest paid on business debts for taxpayers with average annual gross receipts exceeding $25 million. The allowable deduction will be calculated as 30% of adjusted taxable income, defined as earnings before interest, taxes, depreciation and amortization ("EBITDA") for tax years 2018 through 2021. For tax years starting after 12/31/21, the adjusted taxable income will be defined as earnings before interest and taxes ("EBIT"). Disallowed interest will be carried forward indefinitely to be used in a future tax year. Interest attributable to acquiring motor vehicles to be held as inventory for sale or lease is not subject to the limitation on interest deductions.

Technical Terminations for Partnerships

The new law repealed the technical termination provisions. Effective for years beginning after 12/31/17, a partnership will <u>not</u> automatically terminate if there is a sale or exchange of more than a 50% interest in the entity. This will eliminate the need for closing the books to complete two tax returns, restarting depreciation lives, and maintaining partnership elections as required under the repealed provisions. The termination will only happen if the business is truly closing or if the ownership changes to a single member.

Accounting Methods for Small Taxpayers

The new law expands the availability for small corporations to file as cash basis taxpayers. For C Corporations that have less than $25 million in average gross receipts for the previous 3 years, the cash basis of accounting will be allowed. Corporations meeting the $25 million threshold will be allowed to treat inventories as non-incidental materials and supplies if this treatment conforms to the company's financial statement treatment of inventories. The allocation of overhead to inventory as required by 263A is also exempted for corporations meeting the $25 million threshold as defined above.

TCJA Tax Rate Table

2018 TAX SUMMARY

FEDERAL INCOME TAX RATES

Single		Married, filing jointly		Head of Household (HOH)		Married, filing separately	
$0-$9,525	10%	$0-$19,050	10%	$0-$13,600	10%	$0-$9,525	10%
$9,525-$38,700	12%	$19,050-$77,400	12%	$13,600-$51,800	12%	$9,525-$38,700	12%
$38,700-$82,500	22%	$77,400-$165,000	22%	$51,800-$82.500	22%	$38,700-$82,500	22%
$82,500-$157,500	24%	$165,000-$315,000	24%	$82,500-$157,500	24%	$82,500-$157,500	24%
$157,500-$200,000	32%	$315,000-$400,000	32%	$157,500-$200,000	32%	$157,500-$200,000	32%
$200,000-$500,000	35%	$400,000-$600,000	35%	$200,000-$500,000	35%	$200,000-$300,000	35%
Over $500,000	37%	Over $600,000	37%	Over $500,000	37%	Over $300,000	37%

Standard deduction		Estates and trusts	
Single	$12,000	$0-$2,550	10%
Married, filing jointly	$24,000	$2,550-$9,150	24%
Head of household	$18,000	$9,150-$12,500	35%
Married, filing separately	$12,000	Over $12,500	37%

Rates for long-term capital gains and qualified dividends

Individuals		Head of Household		Married, filing jointly		Married, filing seperately		Estates & Trusts	
$0-$38,600	0%	$0-$51,700	0%	$0-$77,200	0%	$0-$38,600	0%	$0-$2,550	10%
$38,600-$425,800	15%	$51,700-$452,400	15%	$77,200-$479,000	15%	$38,600-$239,500	15%	$2,500-$9,150	24%
Over $425,800	20%	Over $452,400	20%	Over $479,000	20%	Over $239,500	20%	$9,150-$12,500	35%
Collectibles	28%							Over $12,500	37%

FEDERAL GIFT AND ESTATE TAX	
Gift tax annual exclusion	$15,000
Annual exclusion for gift to noncitizen spouse	$152,000
Highest estate and gift tax rate	40%
Unified estate and gift tax credit amount	$11,200,000
Generation-skipping transfer tax exclusion	$11,200,000
Unused credit can pass to the surviving spouse if decedent spouse elects on Form 706	

3.8% Medicare surtax thresholds	
Single or HOH	$200,000
Married, filing jointly	$250,000
Married, filing separately	$125,000
Estates and trusts	$12,500

IRA	
IRA contribution (under age 50)	$5,500
IRA contribution (50 and older)	$6,500
Single or HOH phaseout	$63,000-$73,000
Married, filing jointly	$101,000-$121,000
Married, filing separately	$0-$10,000
Estates and trusts	$189,000-$199,000
Phase-out of Roth IRA contribution eligibility	
Single phase out	$120,000-$135,000
Married, filing jointly	$189,000-$199,000
Married, filing separately	$0-$10,000

SOCIAL SECURITY	
Maximum earnings (during working years) subject to payroll tax	$128,400
Social Security payroll tax	Employees pay 7.65%
	Self-employed pay 15.30%
Additional 0.9% high-income payroll tax for wages in excess of:	
Single or HOH	$200,000
Married, filing jointly	$250,000
Married, filing separately	$125,000
Income (in retirement) causing Social Security benefits to be taxable	
Single or HOH	
Up to 50% taxable	$25,000 MAGI
Up to 85% taxable	$34,000 MAGI
Married, filing jointly	
Up to 50% taxable	$32,000 MAGI
Up to 85% taxable	$44,000 MAGI

Max earnings (from a job) between age 62 and full (normal) Social Security retirement age before Social Security benefits reduced $1 for every $2 about $17,040. For individuals who reach FRA in 2018, $1 for every additional $3 earned: $45,360 up until first of month of birthday. Thereafter unlimited.

SEP	
SEP contribution	Up to 25% of compensation (limit $55,000)
Minimum compensation participant	$600
SIMPLE	
SIMPLE elective deferral (under age 50)	$12,500
SIMPLE elective deferral (50 and older)	$15,500

Individual 401(k)	
Employer contribution	Up to 25% of compensation
Employee salary deferral (under 50)	$18,500
Employee salary deferral (50 and older)	$24,500
Total employer and employee	$55,000 ($61,000 age 50 and older)

Other qualified plans	
401(k), 403(b), governmental 457(b), and SARSEP elective deferral (under ago 50)	$18,500
401(k), 403(b), governmental 457(b), and SARSEP elective deferral (age 50 and older)	$24,500
Limit on additions to defined contribution plans	$55,000
Annual benefit limit on defined benefit plans	$220,000
Highly compensated employee makes	$120,000
Maximum compensation taken into account for qualified plans	$275,000
HSA contribution individual coverage	$3,450
HAS contribution family coverage	$6,900

EDUCATION		
Student loan interest deduction		$2,500
Phase-out:	Single	$65,000-$80,000
	Married, filing jointly	$135,000-$165,000
American Opportunity Tax Credit (Hope Scholarship Credit)		
Phase-out:	Single	$80,000-$90,000
	Married, filing jointly	$160,000-$180,000
Lifetime learning credit		20% of qualified expenses up to $10,000
Phase-out:	Single or HOH	$57,000-$67,000
	Married, filing jointly	$114,000-$134,000