Tax Law Changes for Individuals

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Individual Taxes, Rates, Health Care Mandate, Etc.

New income tax rates & brackets

New law. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, seven tax rates apply for individuals: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The Act also provides four tax rates for estates and trusts: 10%, 24%, 35%, and 37%. (**Code Sec. 1(i)**, as amended by Act Sec. 11001)

Marginal Tax Rate	Single	Married Filing Jointly	Head of Household
10%	$0-$9,525	$0-$19,050	$0-$13,600
12%	$9,525-$38,700	$19,050-$77,400	$13,600-$51,800
22%	$38,700-$82,500	$77,400-$165,000	$51,800-$82,500
24%	$82,500-$157,500	$165,000-$315,000	$82,500-$157,500
32%	$157,500-$200,000	$315,000-$400,000	$157,500-$200,000
35%	$200,000-$500,000	$400,000-$600,000	$200,000-$500,000
37%	Over $500,000	Over $600,000	Over $500,000

2017 Tax Rates

2017 Individual Income Tax Brackets		
Rate	Single Taxable Income	Married Filing Jointly Taxable Income
10%	$0 - $9,325	$0 - $18,650
15%	$9,326 - $37,950	$18,651 - $75,900
25%	$37,951 - $91,900	$75,901 - $153,100
28%	$91,901 - $191,650	$153,101 - $233,350
33%	$191,651 - $416,700	$233,351 - $416,700
35%	$416,701 - $418,400	$416,701 - $470,700
39.6%	more than $418,400	more than $470,700

Individual Taxes, Rates, Health Care Mandate, Etc.

Standard deduction increased

New law. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers, adjusted for inflation in tax years beginning after 2018. No changes are made to the current-law additional standard deduction for the elderly and blind. (**Code Sec. 63(c)(7)**, as added by Act Sec. 11021(a))

Standard Deduction + Personal Exemption		
Filing Status	**2017**	**2018**
Single	$6,350	**$6,500**
Married Jointly + Surviving Spouses	$12,700	**$13,000**
Married Separately	$6,350	**$6,500**
Head of Household	$9,350	**$9,550**
Personal Exemption	$4,050	**$4,150**

Individual Taxes, Rates, Health Care Mandate, Etc.

Personal exemptions suspended

New law. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for personal exemptions is effectively suspended by reducing the exemption amount to zero. (**Code Sec. 151(d)**, as modified by Act Sec. 11041(a)) A number of corresponding changes are made throughout the Code where specific provisions contain references to the personal exemption amount in **Code Sec. 151(d)**, and in each of these instances, the dollar amount to be used is $4,150, as adjusted by inflation. These include **Code Sec. 642(b)(2)(C)** (exemption deduction for qualified disability trusts), **Code Sec. 3402** (wage withholding, subject to an exception below for 2018), and **Code Sec. 6334(d)** (property exempt from levy).

PERSONAL AND DEPENDENCY EXEMPTIONS (You, Your Spouse, & Your Dependents)		
	Pre-existing law	New law
Exemption	$4,150	No personal exemption

Capital Gain Rates For 2018

New Law. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026

- The 0% tax rate applies to adjusted net capital gain up to $77,200 for joint filers and surviving spouses, $51,700 for heads of household, $38,600 for single filers, $38,600 for married taxpayers filing separately, and $2,600 for estates and trusts;
- the 15% tax rate applies to adjusted net capital gain over the amount subject to the 0% rate, and up to $479,000 for joint filers and surviving spouses, $452,400 for heads of household, $425,800 for single filers, $239,500 for married taxpayers filing separately, and $12,700 for estates and trusts; and
- the 20% tax rate applies to adjusted net capital gain over $479,000 for joint filers and surviving spouses, $452,400 for heads of household, $425,800 for single filers, $239,500 for married taxpayers filing separately, and $12,700 for estates and trusts.

Personal Deductions, Exclusions & Credits

New law. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, subject to the exception described below, State, local, and foreign property taxes, and State and local sales taxes, are deductible only when paid or accrued in carrying on a trade or business or an activity described in **Code Sec. 212** (generally, for the production of income). State and local income, war profits, and excess profits taxes are not allowable as a deduction.

However, a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the *aggregate* of (i) State and local property taxes *not* paid or accrued in carrying on a trade or business or activity described in **Code Sec. 212**; and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the tax year. Foreign real property taxes may not be deducted. (**Code Sec. 164(b)(6)**, as amended by Act Sec. 11042)

Personal Deductions, Exclusions & Credits

- State and local tax deduction limited
- Mortgage & home equity indebtedness interest deduction limited
- Medical expense deduction threshold temporarily reduced ⬇
- Charitable contribution deduction limitation increased ⬆
- No deduction for amounts paid for college athletic seating rights
- Alimony deduction by pay or/inclusion by payee suspended
- Miscellaneous itemized deductions suspended
- Overall limitation (“Pease” limitation) on itemized deductions suspended
- Qualified bicycle commuting exclusion suspended
- Exclusion for moving expense reimbursements suspended
- Moving expenses deduction suspended
- Student loan discharged on death or disability
- Deduction for living expenses of members of congress eliminated
- Combat zone treatment extended to Egypt’s Sinai Peninsula
- Child tax credit increased ⬆

Qualified Business Income Deduction

Under pre-Tax Cuts and Jobs Act law, there was no special deduction for qualified business income (QBI).

New Law. The Tax Cuts and Jobs Act adds a new deduction for noncorporate taxpayers for qualified business income. The deduction is also referred to as the "pass-through deduction." The deduction reduces taxable income, rather than adjusted gross income, but is available to taxpayers who take the standard deduction. In general, the deduction cannot exceed 20% of the excess of the taxpayer's taxable income over net capital gain.

- The deduction is generally 20% of a taxpayer's qualified business income (QBI) from a partnership, S corporation, or sole proprietorship, defined as the net amount of items of income, gain, deduction, and loss with respect to the trade or business;

- Taxpayers in service related businesses, such as healthcare professionals, law, accounting, actuarial science, performing artists, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees are eligible. However, the deduction for taxpayers in service businesses is phased out if the taxpayer's taxable income exceeds the threshold amount of $157,500 ($315,000 in the case of a joint return);

Qualified Business Income Deduction

- Taxpayers whose taxable income exceeds the threshold amount of $157,500 ($315,000 in the case of a joint return) are also subject to limitations based on the W-2 wages and the adjusted basis in acquired qualified property;
- The deduction is taken for partnerships and S corporations at the partner or shareholder level. Trusts and estates are eligible for the deduction. W-2 wages and the adjusted basis in acquired qualified property are apportioned between the trust or estate and the beneficiaries;
- Qualified business income includes only income effectively connected with a U.S. trade or business. However, qualified business income from sources within Puerto Rico is eligible for the deduction if all the income is subject to tax in the U.S;
- The deduction will not apply to tax years beginning after Dec. 31, 2025;
- The deduction is intended to reduce the tax rate on qualified business income to a rate that is closer to the corporate tax rate.

Deferred Compensation & Tax-Preferred Accounts

New Law. Generally effective with respect to stock attributable to options exercised or restricted stock units (RSUs) settled after Dec. 31, 2017 (subject to a transition rule; see below), a qualified employee can elect to defer, for income tax purposes, recognition of the amount of income attributable to qualified stock transferred to the employee by the employer. (**Code Sec. 83(i)**, as amended by Act Sec. 13603(a)) The election applies only for income tax purposes; the application of FICA and FUTA is not affected.

The election must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier. (**Code Sec. 83(i)(4)(A)**, as added by Act Sec. 13603(a)) If the election is made, the income has to be included in the employee's income for the tax year that includes the earliest of:

1. The first date the qualified stock becomes transferable, including, solely for this purpose, transferable to the employer.
2. The date the employee first becomes an "excluded employee" (i.e., an individual: (a) who is one-percent owner of the corporation at any time during the 10 preceding calendar years; (b) who is, or has been at any prior time, the chief executive officer or chief financial officer of the corporation or an individual acting in either capacity; (c) who is a family member of an individual described in (a) or (b); or (d) who has been one of the four highest compensated officers of the corporation for any of the 10 preceding tax years.
3. The first date on which any stock of the employer becomes readily tradable on an established securities market.
4. The date five years after the first date the employee's right to the stock becomes substantially vested.
5. The date on which the employee revokes his or her election. (**Code Sec. 83(i)(1)(B)**, as amended by Act Sec. 13603(a))

Ordinary Income/Capital Gains Treatment

New holding period required for “carried interest”.

New law. Effective for tax years beginning after Dec. 31, 2017, the Act effectively imposes a 3-year holding period requirement in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain. (**Code Sec. 1061**, “Partnership Interests Held in Connection with Performance of Services,” added by Act Sec. 13309(a)) If the 3-year holding period is not met with respect to an applicable partnership interest held by the taxpayer, the taxpayer's gain will be treated as short-term gain taxed at ordinary income rates. (**Code Sec. 1061(a)**)

Ordinary Income/Capital Gains Treatment

Certain self-created property not treated as capital asset.

New law. Effective for dispositions after Dec. 31, 2017, the Act amends **Code Sec. 1221(a)(3)**, resulting in the exclusion of patents, inventions, models or designs (whether or not patented), and secret formulas or processes, which are held either by the taxpayer who created the property or by a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created), from the definition of a "capital asset." (**Code Sec. 1221(a)(3)**, amended by Act Sec. 13314)

Alternative Minimum Tax Exemption Amounts For Individuals Increased

New Law. For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Tax Cuts and Jobs Act **(Code Sec. 55(d)(4)(A) as amended by 2017 Tax Cuts and Jobs Act §12003(a))**temporarily increases **(Com Rept, see ¶5029)** the statutory AMT exemption amounts **(Code Sec. 55(d)(4)(A)(i))**:

- For marrieds filing jointly/surviving spouses—to $109,400 (from $78,750); and for other unmarrieds—to $70,300 (from $50,600).
- The Tax Cuts and Jobs Act doesn't increase the statutory ($22,500) AMT exemption amount for estates and trusts.
- Because the Code sets the AMT exemption amount for marrieds filing separately at 50% of the marrieds-filing-jointly amount, the changes above also increase the statutory AMT exemption amount for marrieds filing separately—to $54,700 (from $39,375).

Alternative Minimum Tax Exemption Amounts For Individuals Increased

Also, for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Tax Cuts and Jobs Act **(Code Sec. 55(d)(4)(A))** temporarily increases **(Com Rept, see ¶5029)** the statutory AMTI threshold amounts for phase-out of the exemption amounts **(Code Sec. 55(d)(4)(A)(ii))**:

- For marrieds filing jointly/surviving spouses—to $1,000,000 (from $150,000) and for other unmarrieds (but, not for estates or trusts) —to 50% of the amount in (I) above, i.e., $500,000 (from $112,500).
- Because the Code sets the AMTI exemption phase-out threshold amount for marrieds filing separately at 50% of the marrieds-filing-jointly amount, the changes above also increase the statutory AMTI exemption phase-out threshold amount for marrieds filing separately—to $500,000 (from $75,000).

529 Plans

TCJA allows $10,000 per year of 529 plan account funds to be used for elementary or secondary school tuition:

- A 529 plan distribution is tax-free if it is used to pay "qualified higher education expenses" of the beneficiary (student). Before the TCJA made these changes, tuition for elementary or secondary schools wasn't a "qualified higher education expense," so students/529 beneficiaries who had to pay it couldn't receive tax-free 529 plan distributions;

- The TCJA provides that qualified higher education expenses now include expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. Thus, tax-free distributions from 529 plans can now be received by beneficiaries who pay these expenses, effective for distributions from 529 plans after 2017;

- There is a limit to how much of a distribution can be taken from a 529 plan for these expenses. The amount of cash distributions from all 529 plans per single beneficiary during any tax year can't, when combined, include more than $10,000 for elementary school and secondary school tuition incurred during the tax year.

Retirement Plan Provisions

Repeal of the rule allowing recharacterization of IRA contributions.

New law. For tax years beginning after Dec. 31, 2017, the rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA does not apply to a conversion contribution to a Roth IRA. Thus, recharacterization cannot be used to unwind a Roth conversion. (**Code Sec. 408A(d)**, as amended by Act Sec. 13611)

Retirement Plans

Special rule allowing recharacterization of Roth IRA contributions and traditional IRA contributions does not apply to conversion contributions to a Roth IRA:

- Under pre-Tax Cuts and Jobs Act law, the Roth IRA rules allowed an individual to elect to “recharacterize” an IRA contribution—i.e., elect to treat a contribution made to one type of IRA as made to a different type of IRA in a so-called “conversion contribution”—by (a) transferring the contribution (or a portion of the contribution) from the first IRA to the second IRA in a trustee-to-trustee transfer, and (b) meeting specific requirements regarding the transfer.

- **New Law.** Under the Tax Cuts and Jobs Act, the provision allowing taxpayers to recharacterize Roth IRA contributions and traditional IRA contributions does not apply to a conversion contribution to a Roth IRA.

- Thus, recharacterization cannot be used to unwind a Roth conversion. However, recharacterization is still permitted with respect to other contributions. For example, an individual may make a contribution for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA. In addition, an individual may still make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA, but the provision precludes the individual from later unwinding the conversion through a recharacterization.

Retirement Plans

Rollover period for plan loan offset amounts is extended from 60 days, to tax return due date:

- **New Law.** The Tax Cuts and Jobs Act provides that the **Code Sec. 402(c)(1)** tax-free rollover rule does not apply to any transfer of a "qualified plan loan offset amount" made after the due date (including extensions) for filing the tax return for the tax year in which that amount is treated as distributed from a "qualified employer plan."

- Thus, under the Tax Cuts and Jobs Act, the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a tax-free rollover contribution is extended from 60 days after the date of the offset, to the due date (including extensions) for filing the federal income tax return for the tax year in which the plan loan offset occurs, that is, the taxable year in which the amount is treated as distributed from the plan. So, in addition to the hardship exception (as provided under pre-Tax Cuts and Jobs Act law), the Act provides that the 60-day rollover requirement won't apply to transfers of certain plan loan offset amounts.

TCJA will end alimony-payer deduction and payee's income inclusion for post-2018 divorces and separations

- **Current rules.** Under the current rules, an individual who pays alimony may deduct an amount equal to the alimony or separate maintenance payments paid during the year as an “above-the-line” deduction. (An “above-the-line” deduction, i.e., a deduction that a taxpayer need not itemize deductions to claim, is more valuable for the taxpayer than an itemized deduction.)
  - And, under current rules, alimony and separate maintenance payments are taxable to the recipient spouse (includible in that spouse's gross income).
  - Please note that the tax rules for *child support*—i.e., that payers of child support don't get a deduction, and recipients of child support don't have to pay tax on those amounts—is unchanged.

- **TCJA rules.** Under the TCJA rules, there is no deduction for alimony for the payer. Furthermore, alimony is not gross income to the recipient. So for divorces and legal separations that are executed (i.e., that come into legal existence due to a court order) after 2018, the alimony-paying spouse won't be able to deduct the payments, and the alimony-receiving spouse doesn't include them in gross income or pay federal income tax on them.

- **TCJA rules don't apply to existing divorces and separations.** It's important to emphasize that the current rules continue to apply to already-existing divorces and separations, as well as divorces and separations that are executed *before 2019.*

- **Some taxpayers may want the TCJA rules to apply to their existing divorce or separation.** Under a special rule, if taxpayers have an existing (pre-2019) divorce or separation decree, and they have that agreement legally modified, then the new rules don't apply to that modified decree, unless the modification *expressly provides* that the TCJA rules are to apply. There may be situations where applying the TCJA rules voluntarily is beneficial for the taxpayers, such as a change in the income levels of the alimony payer or the alimony recipient.

TCJA doubles the child tax credit and allows a new lower credit for other dependents

- Under pre-Act law, the child tax credit was $1,000 per qualifying child, but it was reduced for married couples filing jointly by $50 for every $1,000 (or part of a $1,000) by which their adjusted gross income (AGI) exceeded $110,000. (The threshold was $55,000 for married couples filing separately, and $75,000 for unmarried taxpayers.) To the extent the $1,000-per-child credit exceeded your tax liability, it resulted in a refund up to 15% of your earned income (e.g., wages, or net self-employment income) above $3,000. For taxpayers with three or more qualifying children, the excess of the taxpayer's social security taxes for the year over the taxpayer's earned income credit for the year was refundable. In all cases the refund was limited to $1,000 per qualifying child.

- Starting in 2018, the TCJA doubles the child tax credit to $2,000 per qualifying child under 17. It also allows a new $500 credit (per dependent) for any of your dependents who are not qualifying children under 17. There is no age limit for the $500 credit, but the tax tests for dependency must be met. Under the Act, the refundable portion of the credit is increased to a maximum of $1,400 per qualifying child. In addition, the earned threshold is decreased to $2,500 (from $3,000 under pre-Act law), which has the potential to result in a larger refund. The $500 credit for dependents other than qualifying children is nonrefundable.

- The Act also substantially increases the "phase-out" thresholds for the credit. Starting in 2018, the total credit amount allowed to a married couple filing jointly is reduced by $50 for every $1,000 (or part of a $1,000) by which their AGI exceeds $400,000 (up from the pre-Act threshold of $110,000). The threshold is $200,000 for all other taxpayers. So, if you were previously prohibited from taking the credit because your AGI was too high, you may now be eligible to claim the credit.

- In order to claim the credit for a qualifying child, you *must* include that child's Social Security number (SSN) on your tax return. Under pre-Act law you could also use an individual taxpayer identification number (ITIN) or adoption taxpayer identification number (ATIN). If a qualifying child does not have an SSN, you will not be able to claim the $2,000 credit, but you can claim the $500 credit for that child using an ITIN or an ATIN. The SSN requirement does not apply for non-qualifying-child dependents, but you must provide an ITIN or ATIN for each dependent for whom you are claiming a $500 credit.

- The changes made by the Act should make these credits more valuable and more widely available to many taxpayers.

TCJA severely cuts personal casualty and theft loss deductions

New limits placed on individuals' itemized deductions of casualty and theft losses that were made by the massive Tax Cuts and Jobs Act (TCJA) effective beginning in 2018 include the following:

- Before the TCJA, individuals could claim as itemized deductions certain personal casualty losses, not compensated by insurance or otherwise, including losses arising from fire, storm, shipwreck, or other casualty, or from theft. There were two limitations to qualify for a deduction: (1) a loss had to exceed $100, and (2) aggregate losses could be deducted only to the extent they exceeded 10% of adjusted gross income.

- *Severe cutback.* For tax years 2018 through 2025, the personal casualty and theft loss deduction isn't available, except for casualty losses incurred in a federally declared disaster. So a taxpayer who suffers a personal casualty loss from a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act still will be able to claim a personal casualty loss as an itemized deduction, subject to the $100-per-casualty and 10%-of-AGI limitations mentioned above. Also, where a taxpayer has personal casualty gains, personal casualty losses can still be offset against those gains, even if the losses aren't incurred in a federally declared disaster.

- *Insurance check needed.* The casualty loss deduction helped to lessen the financial impact of casualty and theft losses on individuals. Now that the deduction generally won't be allowed, except for declared disasters, you may want to review your homeowner, flood, and auto insurance policies to determine if you need additional protection.

Like-kind exchanges are limited to exchanges of real estate

New Law. In light of the increased and expanded expensing under **Code Sec. 168(k)** (**¶ 1201** et seq.) and **Code Sec. 179** (**¶ 1101** et seq.) for tangible personal property and certain building improvements, Congress believed that **Code Sec. 1031** should be limited to exchanges of real property not held primarily for sale. **(Com Rept, see ¶5046)**.

- Specifically, no gain or loss is recognized on the exchange of *real* property held for productive use in a trade or business or for investment if the *real* property is exchanged solely for *real* property of like kind which is to be held either for productive use in a trade or business or for investment.
- Congress intended that real property eligible for like-kind exchange treatment under pre-Tax Cuts and Jobs Act law would continue to be eligible for like-kind exchange treatment.
- **Property excluded from like-kind exchange rule -** The Tax Cuts and Jobs Act strikes the rules providing that exchanges of certain types of property (stock in trade or other property held primarily for sale, stocks, bonds, or notes, other securities, or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interest, or choses in action) are excluded from nonrecognition under **Code Sec. 1031(a)**. **(Code Sec. 1031(a)(2) as amended by 2017 Tax Cuts and Jobs Act §13303(b)(1)(A))**

Provisions That Sunset Under the TCJA

Unless otherwise noted, the provisions discussed below are effective for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026. For calendar-year taxpayers (nearly all individuals), this means that the provisions are effective for 2018-2025.

- **New income tax rates & brackets.** Seven tax rates apply for individuals: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The Act also provides four tax rates for estates and trusts: 10%, 24%, 35%, and 37%.

- **Standard deduction increased.** The standard deduction is increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other taxpayers, adjusted for inflation in the 2019-2025 tax years. No changes are made to the current-law additional standard deduction for the elderly and blind.

- **Personal exemption set to $0.** The deduction for personal exemptions is effectively eliminated for 2018-2025 by reducing the exemption amount to zero.

- **New limitation on "excess business loss."** The Act provides that excess business losses aren't allowed for the tax year but are instead carried forward and treated as part of the taxpayer's net operating loss (NOL) carryforward in subsequent tax years. A taxpayer has an excess business loss if the taxpayer's losses from all trades or businesses exceeds income from the trades or businesses by more than $250,000 ($500,000 for taxpayers who file joint returns). The $250,000/$500,000 amount is adjusted for inflation in years after 2018.

- **Deduction for personal casualty & theft losses not allowed.** The personal casualty and theft loss deduction isn't allowed, except for personal casualty losses incurred in a federally declared disaster. However, where a taxpayer has personal casualty gains, personal casualty losses can still be offset against those gains, even if the losses aren't incurred in a federally declared disaster.

- **Gambling loss limitation modified.** The limitation on wagering losses is modified to provide that *all* deductions for expenses incurred in carrying out wagering transactions, and not just gambling losses, are limited to the extent of gambling winnings.

Provisions That Sunset Under the TCJA Cont.

- **Child tax credit increased.** The child tax credit is increased to $2,000, and other changes are made to phase-outs and refundability during this same period. In addition, taxpayers are allowed a $500 credit for each dependent who isn't a qualifying child.

- **State and local tax deduction limited.** Subject to the exception described below, state, local, and foreign property taxes, and state and local sales taxes, are deductible only when paid or accrued in carrying on a trade or business or income-producing activity. State and local income, war profits, and excess profits aren't allowable as a deduction. However, a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the *aggregate* of (i) state and local property taxes *not* paid or accrued in carrying on a trade or business or income-producing activity; and (ii) state and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the tax year. Foreign real property taxes may not be deducted.

- **Mortgage & home equity indebtedness interest deduction limited.** The deduction for interest on home equity indebtedness is eliminated for 2018-2025, and the deduction for interest on “acquisition indebtedness” is limited to underlying indebtedness of up to $750,000 ($375,000 for married taxpayers filing separately). Acquisition indebtedness is generally debt a taxpayer incurred in acquiring, constructing or substantially improving the taxpayer's home or second residence. Congress ultimately didn't adopt a proposal to eliminate the mortgage interest deduction for mortgages on a taxpayer's second residence.

- **Medical expense deduction threshold temporarily reduced.** For tax years beginning after Dec. 31, 2016 and ending before Jan. 1, 2019, the threshold on medical expense deductions is reduced to 7.5% of adjusted gross income (AGI) for all taxpayers (from 10%).

- **Charitable contribution deduction limitation increased.** The 50% limitation under **Code Sec. 170(b)** for cash contributions to public charities and certain private foundations is increased to 60%. Contributions exceeding the 60% limitation are generally allowed to be carried forward and deducted for up to five years, subject to the later year's ceiling.

Provisions That Sunset Under the TCJA Cont.

- **Miscellaneous itemized deductions not allowed.** The deduction for miscellaneous itemized deductions (which had previously been subject to the 2%-of-AGI "haircut") isn't allowed.

- **Overall limitation ("Pease" Limitation) on itemized deductions not applicable.** The "Pease limitation" on itemized deductions doesn't apply.

- **Qualified bicycle commuting exclusion not applicable.** The exclusion from gross income and wages for qualified bicycle commuting reimbursements doesn't apply.

- **Exclusion for moving expense reimbursements not applicable.** The exclusion for qualified moving expense reimbursements doesn't apply, except for members of the Armed Forces on active duty (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

- **Moving expenses deduction not applicable.** The deduction for moving expenses doesn't apply, except for members of the Armed Forces on active duty who move pursuant to a military order and incident to a permanent change of station.

- **AMT retained, with higher exemption amounts.** The Act increases the alternative minimum tax (AMT) exemption amounts for individuals as follows:
  - For joint returns and surviving spouses, $109,400.
  - For single taxpayers, $70,300.
  - For married couples filing separately, $54,700.

- **ABLE account changes.** Effective for tax years beginning after Dec. 22, 2017 (the enactment date of the TCJA) and before Jan. 1, 2026, the contribution limitation to ABLE accounts with respect to contributions made by the designated beneficiary is increased, and other changes are in effect. After the overall limitation on contributions is reached (i.e., the annual gift tax exemption amount; for 2018, $15,000), an ABLE account's designated beneficiary can contribute an additional amount, up to the lesser of (a) the federal poverty line for a one-person household; or (b) the individual's compensation for the tax year.

Provisions That Sunset Under the TCJA Cont.

- **New deduction for pass-through income.** Generally for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act adds a new section, **Code Sec. 199A**, "Qualified Business Income," under which a non-corporate taxpayer, including a trust or estate, who has qualified business income (QBI) from a partnership, S corporation, or sole proprietorship is generally allowed a deduction equal to the lesser of 20% of QBI (not including net capital gains) or 50% of W-2 wages paid by the partnership, S corporation, or sole proprietorship. But the deduction can't exceed the taxpayer's taxable income, reduced by net capital gain.

- **Deduction for foreign-derived intangible income and GILTI.** In the case of a domestic corporation, a deduction is allowed in an amount equal to the sum of: (i) 37.5% of the foreign-derived intangible income (FDII) of the domestic corporation for the tax year, plus (ii) 50% of the global intangible low-taxed income (GILTI) amount (if any) which is included in the gross income of the domestic corporation under **Code Sec. 951A** for the tax year. For tax years beginning after Dec. 31, 2025, those amounts are reduced to 21.875% and 37.5%, respectively. FDII of a domestic corporation is the amount which bears the same ratio to the corporation's deemed intangible income as its foreign-derived deduction eligible income bears to its deduction eligible income. The deduction is intended to partially offset the provision in the TCJA including FDII and GILTI in income.

- **Election with respect to foreign tax credit limitation.** Under pre-TCJA law, for purposes of the limitation on the foreign tax credit, if a taxpayer sustains an overall domestic loss for any tax year, then, for each succeeding year, an amount of U.S. source taxable income, equal to the lesser of either the full amount of the loss to the extent not carried back to prior tax years or 50% of the taxpayer's U.S. source taxable income for that succeeding tax year, is recharacterized as foreign source income. For any tax year of a taxpayer that begins after Dec. 31, 2017 and before Jan. 1, 2028, the taxpayer may, with respect to pre-2018 unused overall domestic losses, elect to substitute, for 50% of the taxpayer's U.S. source taxable income for that succeeding tax year, a percentage greater than 50% but not greater than 100%.

Provisions That Sunset Under the TCJA Cont.

- **Student loan discharged on death or disability.** Certain student loans that are discharged on account of death or total and permanent disability of the obligor are excluded from gross income.

- **Estate and gift tax retained, with increased exemption amount.** For estates of decedents dying and gifts made after Dec. 31, 2017 and before Jan. 1, 2026, the Act doubles the base estate and gift tax exemption amount from $5 million to $10 million.

- **Temporary 100% cost recovery of qualifying business assets.** A 100% first-year deduction for the adjusted basis is allowed for qualified property acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023 (after Sept. 27, 2017, and before Jan. 1, 2024, for certain property with longer production periods). The additional first-year depreciation deduction is allowed for new and used property.

- **New credit for employer-paid family and medical leave.** For wages paid in tax years beginning after Dec. 31, 2017, but not beginning after Dec. 31, 2019, the Act allows businesses to claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave (FMLA) if the rate of payment is 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%. All qualifying full-time employees have to be given at least two weeks of annual paid family and medical leave (all less-than-full-time qualifying employees have to be given a commensurate amount of leave on a pro rata basis).

Estate Tax Exclusion

Estate tax basic exclusion amount increased from $5 million to $10 million:

- **<u>New Law.</u>** Under the Tax Cuts and Jobs Act, the basic exclusion amount is increased from $5 million to $10 million for estates of decedents dying and gifts made after 2017, and before 2026.

- The $10 million amount is indexed for inflation occurring after 2011.
- The doubling of the basic exclusion amount will cause many estates to no longer be subject to federal estate taxation. Before adjusting a client's estate planning, however, consider whether the client will be subject to state estate tax. Illinois, for example, has a $4 million per person exemption, and while such a tax is deductible against the federal estate tax, if no federal estate tax is due the state estate tax is effectively increased.
- The increased GST exemption may be an opportunity to address existing irrevocable trusts. For clients who have created any irrevocable trusts that have inclusion ratios greater than zero and where assets may ultimately pass to skip persons (either by design or due to changed facts), consider making a late allocation of GST exemption where appropriate to cause such trusts to have inclusion ratios of zero.
- Regarding modifications to the estate tax payable to reflect different basic exclusion amounts, IRS is directed to prescribe regulations that may be necessary so that <u>Code Sec. 2001(g)</u> may be carried out with respect to any difference between:
  - the basic exclusion amount in effect at the time of the decedent's death, and
  - the basic exclusion amount applicable with respect to any gifts made by the decedent.

Business Tax Changes in the Tax Cuts and Jobs Act ("TCJA")

Overview:

- *Corporate tax rates reduced.* One of the more significant new law provisions cuts the corporate tax rate to a flat 21%. Before the new law, rates were graduated, starting at 15% for taxable income up to $50,000, with rates at 25% for income between 50,001 and $75,000, 34% for income between $75,001 and $10 million, and 35% for income above $10 million.

- *Dividends-received deduction.* The dividends-received deduction available to corporations that receive dividends from other corporations has been reduced under the new law. For corporations owning at least 20% of the dividend-paying company, the dividends-received deduction has been reduced from 80% to 65% of the dividends. For corporations owning under 20%, the deduction is reduced from 70% to 50%.

- *Alternative minimum tax repealed for corporations.* The corporate alternative minimum tax (AMT) has been repealed by the new law.

- *Alternative minimum tax credit.* Corporations are allowed to offset their regular tax liability by the AMT credit. For tax years beginning after 2017 and before 2022, the credit is refundable in an amount equal to 50% (100% for years beginning in 2021) of the excess of the AMT credit for the year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the credit will be allowed in tax years beginning before 2022.

- *Net Operating Loss ("NOL") deduction modified.* Under the new law, generally, NOLs arising in tax years ending after 2017 can only be carried forward, not back. The general two-year carryback rule, and other special carryback provisions, have been repealed. However, a two-year carryback for certain farming losses is allowed. These NOLs can be carried forward indefinitely, rather than expiring after 20 years. Additionally, under the new law, for losses arising in tax years beginning after 2017, the NOL deduction is limited to 80% of taxable income, determined without regard to the deduction. Carryovers to other years are adjusted to take account of the 80% limitation.

Business Tax Changes in the Tax Cuts and Jobs Act Cont.

Overview:

- Limit on business interest deduction. Under the new law, every business, regardless of its form, is limited to a deduction for business interest equal to 30% of its adjusted taxable income. For pass-through entities such as partnerships and S corporations, the determination is made at the entity, i.e., partnership or S corporation, level. Adjusted taxable income is computed without regard to the repealed domestic production activities deduction and, for tax years beginning after 2017 and before 2022, without regard to deductions for depreciation, amortization, or depletion. Any business interest disallowed under this rule is carried into the following year, and, generally, may be carried forward indefinitely. The limitation does not apply to taxpayers (other than tax shelters) with average annual gross receipts of $25 million or less for the three-year period ending with the prior tax year. Real property trades or businesses can elect to have the rule not apply if they elect to use the alternative depreciation system for real property used in their trade or business. Certain additional rules apply to partnerships.

- Domestic production activities deduction ("DPAD") repealed. The new law repeals the DPAD for tax years beginning after 2017. The DPAD formerly allowed taxpayers to deduct 9% (6% for certain oil and gas activities) of the lesser of the taxpayer's (1) qualified production activities income ("QPAI") or (2) taxable income for the year, limited to 50% of the W-2 wages paid by the taxpayer for the year. QPAI was the taxpayer's receipts, minus expenses allocable to the receipts, from property manufactured, produced, grown, or extracted within the U.S.; qualified film productions; production of electricity, natural gas, or potable water; construction activities performed in the U.S.; and certain engineering or architectural services.

- *New fringe benefit rules.* The new law eliminates the 50% deduction for business-related entertainment expenses. The pre-Act 50% limit on deductible business meals is expanded to cover meals provided via an in-house cafeteria or otherwise on the employer's premises. Additionally, the deduction for transportation fringe benefits (e.g., parking and mass transit) is denied to employers, but the exclusion from income for such benefits for employees continues. However, bicycle commuting reimbursements are deductible by the employer but not excludable by the employee. Last, no deduction is allowed for transportation expenses that are the equivalent of commuting for employees except as provided for the employee's safety.

Business Tax Changes in the Tax Cuts and Jobs Act Cont.

Overview:

- *Penalties and fines.* Under pre-Act law, deductions are not allowed for fines or penalties paid to a government for the violation of any law. Under the new law, no deduction is allowed for any otherwise deductible amount paid or incurred by suit, agreement, or otherwise to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by the government or entity into the potential violation of any law. An exception applies to any payment the taxpayer establishes is either restitution (including remediation of property), or an amount required to come into compliance with any law that was violated or involved in the investigation or inquiry, that is identified in the court order or settlement agreement as such a payment. An exception also applies to an amount paid or incurred as taxes due.

- *Sexual harassment.* Under the new law, effective for amounts paid or incurred after Dec. 22, 2017, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if the payments are subject to a nondisclosure agreement.

- Lobbying expenses. The new law disallows deductions for lobbying expenses paid or incurred after the date of enactment with respect to lobbying expenses related to legislation before local governmental bodies (including Indian tribal governments). Under pre-Act law, such expenses were deductible.

Business Tax Changes in the Tax Cuts and Jobs Act Cont.

Overview:

- *Increased **Code Sec. 179** expensing.* The new law increases the maximum amount that may be expensed under **Code Sec. 179** to $1 million. If more than $2.5 million of property is placed in service during the year, the $1 million limitation is reduced by the excess over $2.5 million. Both the $1 million and the $2.5 million amounts are indexed for inflation after 2018. The expense election has also been expanded to cover (1) certain depreciable tangible personal property used mostly to furnish lodging or in connection with furnishing lodging, and (2) the following improvements to nonresidential real property made after it was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; security systems; and any other building improvements that aren't elevators or escalators, don't enlarge the building, and aren't attributable to internal structural framework.

- Family and medical leave credit. A new general business credit is available for tax years beginning in 2018 and 2019 for eligible employers equal to 12.5% of wages they pay to qualifying employees on family and medical leave if the rate of payment is 50% of wages normally paid to the employee. The credit increases by 0.25% (up to a maximum of 25%) for each percent by which the payment rate exceeds 50% of normal wages. For this purpose, the maximum leave that may be taken into account for any employee for any year is 12 weeks. Eligible employers are those with a written policy in place allowing qualifying full-time employees at least two weeks of paid family and medical leave a year, and less than full-time employees a pro-rated amount of leave. A qualifying employee is one who has been employed by the employer for one year or more, and who, in the preceding year, had compensation not above 60% of the compensation threshold for highly compensated employees. Paid leave provided as vacation leave, personal leave, or other medical or sick leave is not considered family and medical leave.

Business Tax Changes in the Tax Cuts and Jobs Act Cont.

Overview:

- *Bonus depreciation.* Under the new law, a 100% first-year deduction is allowed for qualified new and used property acquired and placed in service after September 27, 2017 and before 2023. Pre-Act law provided for a 50% allowance, to be phased down for property placed in service after 2017. Under the new law, the 100% allowance is phased down starting after 2023.

- *Depreciation of real property.* The new law modified some rules for the depreciation of residential rental buildings and certain building improvements.

- *Depreciation of farming equipment and machinery.* Under the new law, subject to certain exceptions, the cost recovery period for farming equipment and machinery the original use of which begins with the taxpayer is reduced from 7 to 5 years. Additionally, in general, the 200% declining balance method may be used in place of the 150% declining balance method that was required under pre-Act law.

- *Luxury auto depreciation limits.* Under the new law, for a passenger automobile for which bonus depreciation (see above) is not claimed, the maximum depreciation allowance is increased to $10,000 for the year it's placed in service, $16,000 for the second year, $9,000 for the third year, and $5,760 for the fourth and later years in the recovery period. These amounts are indexed for inflation after 2018. For passenger autos eligible for bonus first year depreciation, the maximum additional first year depreciation allowance remains at $8,000 as under pre-Act law.

- *Computers and peripheral equipment.* The new law removes computers and peripheral equipment from the definition of listed property. Thus, the heightened substantiation requirements and possibly slower cost recovery for listed property no longer apply.

Business Tax Changes in the Tax Cuts and Jobs Act Cont.

Overview:

- *New rules for post-2021 research and experimentation ("R & E") expenses.* Under the new law, specified R & E expenses paid or incurred after 2021 in connection with a trade or business must be capitalized and amortized ratably over a 5-year period (15 years if conducted outside the U.S.). These include expenses for software development, but not expenses for land, or depreciable or depletable property used in connection with the R & E (but do include the depreciation and depletion allowance for such property). Under pre-TCJA law, i.e., for R&E expenses paid or incurred before 2022, these expenses are deductible currently or may be capitalized and recovered over the useful life of the research (not to exceed 60 months), or over a ten-year period, at the taxpayer's election.

- *Like-kind exchange treatment limited.* Under the new law, the rule allowing the deferral of gain on like-kind exchanges of property held for productive use in a taxpayer's trade or business or for investment purposes is limited to cover only like-kind exchanges of real property not held primarily for sale. Under a transition rule, the pre-TCJA law applies to exchanges of personal property if the taxpayer has either disposed of the property given up or obtained the replacement property before 2018.

- *Excessive employee compensation.* Under pre-Act law, a deduction for compensation paid or accrued with respect to a covered employee of a publicly traded corporation is deductible only up to $1 million per year. Exceptions applied for commissions, performance-based pay, including stock options, payments to a qualified retirement plan, and amounts excludable from the employee's gross income. The new law repealed the exceptions for commissions and performance-based pay. The definition of "covered employee" is revised to include the principal executive officer, principal financial officer, and the three highest-paid officers. An individual who is a covered employee for a tax year beginning after 2016 remains a covered employee for all future years.

- *Employee achievement awards clarified.* An employee achievement award is tax free to the extent the employer can deduct its cost, generally limited to $400 for one employee or $1,600 for a qualified plan award. An employee achievement award is an item of tangible personal property given to an employee in recognition of length of service or a safety achievement and presented as part of a meaningful presentation. The new law defines "tangible personal property" to exclude cash, cash equivalents, gift cards, gift coupons, gift certificates (other than from an employer pre-selected limited list), vacations, meals, lodging, theater or sports tickets, stocks, bonds, or similar items, and other non-tangible personal property.

THANK YOU!

I hope this information helps you understand these changes. Please feel free to call or email me if you wish to discuss how they or any of the many other changes in the Act could affect your particular tax situation, and the possible planning steps you might consider in response to them.

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