



What Impact Will Tax Reform Have on You?

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H.R.1, described as the "Tax Cuts and Jobs Act¹" (the "Act") and commonly referred to as "Tax Reform", was signed into law by the President on December 22, 2017. Many of the changes contemplated by the Act will be effective for tax years on or after January 1, 2018. These changes may impact your current year-end tax planning. You may even want to consider changing your choice of entity. The highlights from the Act are summarized below.

Individuals:

In an attempt to simplify tax preparation, the Act increases the standard deduction amount, but suspends certain deductions and exemptions. The majority of these changes are not permanent, but instead will sunset on December 31, 2025.

Income tax rates

(married filing jointly)

(single individuals):

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)

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PRACTICE AREAS

Business & Tax

Tax Law



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).

Effective beginning January 1, 2018.

- **Standard Deduction:** The Act makes the following increases to the Standard Deduction:
 - \$24,000 for a joint return
 - \$18,000 for an unmarried filer with at least one child
 - \$12,000 for single filers
- All amounts are indexed for inflation. Effective for tax years beginning January 1, 2018 through tax years ending December 31, 2025.
- **Personal Exemption:** The Act suspends personal exemptions, effective for tax years beginning January 1, 2018 through tax years ending December 31, 2025.
 - **Itemized Deductions:** All deductions subject to the 2% floor are suspended, effective for tax years beginning January 1, 2018 through tax years ending December 31, 2025.
 - This includes expenses attributable to the trade or business of being an employee.
 - **Mortgage Interest Deduction:** The Act suspends the deduction for interest on home equity indebtedness, effective for tax years beginning January 1, 2018 through tax years ending December 31, 2025.

- The deduction for interest on acquisition indebtedness of up to \$750,000 remains available for debt incurred after December 15, 2017. The previous \$1 million limitation will remain for older debt.
- **State and Local Tax Deduction:** The Act eliminates this deduction for individuals, but permits a deduction for businesses.
 - Limited exception for individuals during tax years beginning January 1, 2018 through tax years ending December 31, 2025.
 - Taxpayers who itemize their deductions will be able to deduct up to \$10,000 of state and local income, sales and property taxes.
- **Charitable Contributions:** The AGI limitation on cash contributions to charities is increased from 50% to 60%, effective for contributions made during tax years beginning January 1, 2018 through tax years ending December 31, 2025.
- **Plan of Action:** Make sure your 2017 tax return is completed correctly. Nearly all of the tax reform changes are not effective until the 2018 tax year. Taxpayers should ensure they are claiming deductions while they are still available.

Pass-Through Entities:

Perhaps the most complicated revisions under the Act are the changes impacting the taxation of income received from pass-through entities (limited liability companies, S corporations, etc.). The Act creates a new deduction for certain pass-through income.

- **New Deduction:** The Act creates a new deduction of 20% of “Qualified Business Income” from a partnership, S Corporation, or sole proprietorship.
 - Qualified Business Income is defined as all domestic business income other than investment interest income, short-term capital gains, long-term capital gains, etc.
 - The deduction is limited to 50% of the taxpayer’s allocable W-2 wages paid by the partnership or S corporation.
 - This limit does not apply to a taxpayer with taxable income that does not exceed \$315,000 (for married filing jointly) or \$157,000 (for individuals).
 - An alternative wage limit is available for capital-intensive businesses, where the deduction is instead limited to 25% of wages paid *plus* 5% of the business’s adjusted basis of all qualified property.
 - The deduction is used to reduce taxable income, not in computing adjusted gross income, and the deduction is available to itemizers, non-itemizers, and trusts and estates.

Plan of Action: Schedule meetings with your tax and legal advisers. The points above are only highlights of the changes made by the Act. Based on the extent of your pass-through income, you may want to consider converting your pass-through entity to a C Corporation, given the changes discussed below. Other changes impact partnership accounting rules, including inside basis adjustments for partnership assets with a substantial built-in loss and elimination of the technical terminations rule.

Corporations:

Perhaps the biggest change brought by the Act is a reduction of the corporate tax rate to a flat 21%, while also repealing the maximum corporate tax rate on net capital gain and the alternative minimum tax. Other notable changes include the following:

- **168(k) Expensing:** The Act will permit full expensing for property placed in service after September 27, 2017, with a phase-down of permitted expensing amounts in subsequent tax years:
 - 100% expensing for property placed in service after September 27, 2017 and before January 1, 2023.
 - 80% expensing for the 2023 tax year.
 - 60% expensing for the 2024 tax year.
 - 40% expensing for the 2025 tax year.
 - 20% expensing for the 2026 tax year.
- **DPAD Deduction:** The Act repeals the deduction for income attributable to domestic production activities (aka "DPAD") for all taxpayers beginning January 1, 2018.
- **179 Expensing:** The Act will increase the amount a taxpayer may expense under Section 179 to \$1,000,000. The definition of "qualified real property" will also be expanded to include certain improvements (roofs, HVAC, alarm systems, etc.).
- **Net Operating Losses:** The Act makes substantial changes to the treatment of Net Operating Losses ("NOLs"). Primarily, the Act eliminates NOL carry-backs, while allowing such losses to be carried forward indefinitely.
- **Entertainment and Club Dues:** The Act repeals the deduction previously allowed for entertainment, amusement, or recreation, and membership dues for a clubs.
- **Maternity Leave Credit:** The Act adds a new, temporary credit for businesses providing qualified paid maternity leave to full-time employees. The credit adjusts upwardly based on the percentage of wages paid during leave time.

Plan of Action: Schedule a meeting with your legal and tax advisers to re-evaluate your record keeping and expense planning for 2018. You may want to reallocate budget items away from expenses for which there is no deduction and to expenses that are deductible. For your 2017 tax return, look for property placed in service after September 27, 2017 that may be eligible for 100% expensing under bonus depreciation. For 2018, you may want to consider cost segregation studies to better identify assets eligible for 100% expensing.

The issues summarized above are only a small portion of changes made in the Act. To learn about which changes will impact you or your business specifically, contact your Foster Swift Business Attorney today.

1. The name of the Act was changed by the Senate during final reconciliation.



This piece has been updated from an article originally published on December 20, 2017.

