The Bankler Report

November 20, 2017

INTRODUCTION

On November 16, the U.S. House of Representatives passed H.R. 1 "Tax Cuts and Jobs Act." Meanwhile the U.S. Senate's Finance Committee continued marking up the Chairman's Mark The following is a summary of the major provisions of the Senate bill (unless otherwise noted, all provisions are for taxable years beginning after 2017):

Business Provisions:

1. **Flat Corporate Tax Rate** -The bill would replace the current four-tier schedule of corporate rates (15%, 25%, 34%, and 35%, with a $75,001 threshold for the 34% rate) with a flat 20% rate (including personal services corporations) effective for years beginning after December 31, 2018. The corporate alternative minimum tax (AMT) is repealed along with the individual AMT.
2. **Pass-Thru Business Tax Rate -** The bill creates a "business tax deduction" of 17.4% on "Qualified Business Income" for the owners of S corporations, partnerships and sole proprietorships, limited to 50% of the W-2 wages of the business. (This W-2 limitation would not apply to married filing joint taxpayers with income below $500,000.) This deduction is phased out for married filing joint taxpayers with income in excess of $500,000. However, **service business owners**, such as accountants and lawyers, will only have the benefit of this deduction if their income (married filing joint) is below $500,000. The benefit of this deduction will be phased out over the next $100,000 of income.
3. **Expensing of Asset Acquisitions** – Instead of 50% bonus deprecation, taxpayers would be able to fully and immediately expense 100% of the cost of qualified property (no change in definition "new tangible personal property") acquired and placed in service **after September 27, 2017, and before Jan. 1, 2023.**
4. **Real Property** – The Senate bill would eliminate the differences between residential and nonresidential real estate and shorten the recovery period to 25 years. It would also eliminate the differences between qualified restaurant, qualified leasehold improvement, and qualified retail improvement properties. These costs could now be recovered over 10 years.
5. **Code Sec. 179 Expensing** – Small business expensing of qualified property would be increased to $1 million (from the current $500,000), and the phase-out amount would be increased to $2.5 million (from the current $2 million), effective for tax years beginning after 2017 through tax years beginning before 2023. Both amounts would be indexed for inflation. The definition of section 179 property would also include tangible personal property to furnish lodging or in connection with furnishing lodging. It would also allow this deduction for "qualified real property" which would include roofs, HVAC, fire protection and alarm systems and security systems acquired after the property was first placed into service.
6. **Small Business Accounting Reforms.**
   a. Cash Method of Accounting – Currently small businesses may only use the cash method of accounting if average gross receipts do not exceed $5 million for all prior years. This bill raises the gross receipts test to $15 million and the requirement that such businesses satisfy the requirement for all prior years would be repealed. In addition, businesses with inventories now qualify.
   b. Long-Term Contracts – Non-residential construction contractors will now be allowed to use the completed contract method (instead of the required percentage of completion method) if their average gross receipts is $15 million, up from $10 million. Residential

contractors may be exempt from the percentage of completion method. In addition, Congress is not changing the Tax Court's decision in Shea Homes, Inc.

7. **Like-kind Exchanges** – The current rules will apply, except it will only be allowed for real estate.
8. **Meals & Entertainment** - The 50% limitation under current law would apply **not only to expenses for food or beverages and to qualifying business meals, but also to the expenses of the employer associated with providing food through an eating facility that meets the requirement for de minimis fringe,** with no deduction allowed for other entertainment expenses. Therefore, no deduction would be allowed for entertainment, amusement or recreation activities, facilities, or membership dues relating to such activities or other social purposes. In addition, no deduction would be allowed for transportation fringe benefits, benefits in the form of on-premises gyms and other athletic facilities, or for amenities provided to an employee that are primarily personal in nature and that involve property or services not directly related to the employer's trade or business.
9. **Qualified Production Activity Deduction** – The 9% deduction allowed for these activities are repealed for tax years beginning after 2018.
10. **Net Operating Loss deduction limitation** – The bill provides that taxpayers would be able to deduct a net operating loss (NOL) carryover or carryback only to the extent of 80% of the taxpayer's taxable income (determined without regard to the NOL deduction) rather than the current 100% for small businesses. Deductions eliminated or limited: Deductions of net operating losses (NOLs) would be limited to 80% of taxable income. NOLs would have an indefinite carryforward period, but carrybacks would no longer be available for most businesses. Carryforwards for losses arising after 2018 would be increased by an interest factor.
11. **Interest deduction limitations** – The bill provides that every business, regardless of its form, would be subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. Disallowed interest deductions would be carried forward indefinitely and would apply at the taxpayer level.

12. **Self-Created Property not treated as capital asset** – This House provision was not initially included in the Senate's version of the tax bill.

Individual Provisions:

13. **Ordinary Income Tax Rates** -The Bill would keep the number of tax brackets (7 ranging from 10% to 39.6%): 10%, 12%, 22%, 25%, 32%, 35%, and 38.8%

Comparison of old versus new rates –

Single Taxpayers:

Income Level	Old Rate	New Rate
$0 – $9,525	10%	10%
$9,526-$38,700	15%	12%
$38,701-$70,000	25%	22%
$70,001-$160,000	25%	24%
$160,000-$200,000	28%	32%
$200,001-$500,000	33%	35%
> $500,000	39.6%	38.5%

Married filing Joint Taxpayers:

Income Level	Old Rate	New Rate
$0 – $19,050	10%	10%
$19,051-$77,40	15%	12%
$77,401-$144,000	25%	22%
$144,001-$320,000	25%	24%
$320,000-$400,000	28%	32%
$400,001-$1,000,000	33%	35%
> $1,000,000	39.6%	38.5%

Steven Bankler, CPA, Ltd. 9901 IH 10 W, Suite 670 San Antonio TX 78230 (210) 691-3133
steven@bankler.com www.bankler.com Fax (210) 691-3233

The plan retains the "marriage penalty," with the start of the 35% bracket, which begins at $200,000 for single taxpayers but at only $260,000 (rather than $400,000, or an amount twice the single bracket) for married couples.

14. **Long Term Capital Gains Tax Rates** -The bill would apply a 0% capital gains rate to capital gains "below the 15% rate threshold". A 15% bracket would apply to gains below the 20% rate threshold and the 20% rate would apply thereafter.
15. **ACA (ObamaCare) Net Investment Income Taxes** – The 3.8% tax surcharge **has not been repealed!**
16. **Standard Deduction** – The standard deduction has been increased from (single) $6,350 to $12,000 and from (MFJ) $12,700 to $24,000, **but the personal exemptions have been eliminated.**
17. **Deductions** –
    A. **Eliminated:** Alimony payments, Moving expenses, Contributions to Medical Savings Accounts, Uninsured medical expenses, Personal casualty losses (except for Federal declared disasters), State & Local income taxes, Unreimbursed employee expenses, and Tax preparation fees
    B. **Modified:** Mortgage Interest deductions limited to $1,000,000 acquisition of principal residence mortgages. Real property taxes limited to $10,000.

Estate & Gift Provisions.

18. **Exclusion** - The Act would double the base estate exclusion amount from $5 million (as indexed for inflation; $5.6 million for 2018 per taxpayer) to $10 million.
19. **Repeal of Estate Tax** - The bill would repeal both the Estate and Generation Skipping Transfer taxes for taxpayers dying after December 31, 2023, while still maintaining a beneficiary's stepped-up basis in estate property.
20. **Gift Tax** - The bill would lower the gift tax to a maximum rate of 35% for gifts made after December 31, 2023, retain the basic exclusion amount of $10 million, and an annual exclusion amount of $15,000 (for 2018), as indexed for inflation.

Planning Opportunities.

A. **Defer income (and/or accelerate deductions) to shift taxable income from 2017 to 2018**. The Bill lowers tax rates for taxable incomes below $1,000,000. In addition, the maximum rate of 39.6% (MFJ) is scheduled to start at $1,000,000 instead of $480,051. At $1,000,000 taxable income, a married filing joint return tax liability will be reduced from $154,845 to $130.318~~6,447~~, a reduction of $24~~18~~,547~~398~~. HOWEVER the definition of taxable income has been changed and each taxpayer needs to compute their 2018 expected liability.
B. **Asset Acquisitions** – If you are planning major asset purchases (with useful life of 20 years or less) the next several months (including 2018) you should consider purchasing and PLACING THEM INTO SERVICE on or before December 31, 2017. Careful planning is required as you DO NOT want to completely eliminate your taxable income or create a net operating loss.
C. **Small Business with Inventories** – Since businesses under $25 million with inventories now qualify for the cash method, these businesses should reduce these inventory levels to as low as possible in 2017 and then rebuild them in 2018.
D. **Self-created property** – Property described in #12, when disposed after 2017, would no longer be capital gain property. Consider making a disposition (related party?) of this property before the end of 2017.

This report only discusses proposals that we consider to be of general interest to our readers and is not a complete discussion of the bill's contents. It is anticipated that there will be numerous changes and modifications to these proposals in order to attract additional votes. Please feel free to contact us with your specific questions.

Steven Bankler, CPA, Ltd. 9901 IH 10 W, Suite 670 San Antonio TX 78230 (210) 691-3133
steven@bankler.com www.bankler.com Fax (210) 691-3233