The Bankler Report

December 19, 2017

INTRODUCTION

On December 15, the Conference Committee (composed of members from both the U.S. House of Representatives and the U.S. Senate) released the "final" bill which is scheduled to be voted on this week by both Chambers. If it passes, it is expected to be on President Trump's desk before Christmas. The following is a summary of the major provisions of the 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 21% rate (including personal services corporations) effective for years beginning after December 31, 2017. The corporate alternative minimum tax (AMT) is repealed.
2. **Pass-Thru Business Tax Rate -** The bill creates a "business tax deduction" of 20% 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 $315,000.) This deduction is phased out for married filing joint taxpayers with income in excess of $315,000. However, **service business owners**, such as accountants and lawyers (**but not architects and engineers)**, will only have the benefit of this deduction if their income (married filing joint) is below $315,000. The benefit of this deduction will be phased out over the next $100,000 of income. **Alternatively**, the limitation can be computed as 25% of your share of the W-2 wages paid by the business PLUS 2.5% of the original cost of property used in the production 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 (change in definition "tangible personal property" including used property) acquired and placed in service **after September 27, 2017, and before Jan. 1, 2023.**
4. **Real Property** – The bill would keep the current depreciation periods for both residential and non-residential real property (27.5 and 39 years respectively). It would also eliminate the differences between qualified restaurant, qualified leasehold improvement, and qualified retail improvement properties. These costs could now be recovered over 15 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 $25 million and the requirement that such businesses satisfy the requirement for all prior years would be repealed. In addition, businesses with inventories may now qualify by either: (1) treating inventories as non-incidental materials

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and supplies (See Treas. Reg. §1.162-3(a)(1)), or (2) conforms to the taxpayer's financial accounting treatment of inventories.

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 $25 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 <u>Shea Homes, Inc.</u>

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. **Technical Termination of a Partnership** – Under prior law, if more than 50% of a partnership is sold or transferred, it is treated as a technical termination. This allows the "new" partnership to make all new elections including starting over with deprecation. More importunately, the new Partnership does not "inherit" any old partnership IRS problems (failure to pay employees trust fund taxes, etc). The law repeals this provision.
10. **Qualified Production Activity Deduction** – The 9% deduction allowed for these activities are repealed for tax years beginning after 2018.
11. **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.
12. **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. Not applicable to small businesses or businesses that utilizes "floor plan" financing for qualifying inventory (vehicles, boats, farm machinery, etc. secured by such inventory). This also does not apply to real property trades.
13. **Self-Created Property not treated as capital asset** - Gain or loss from the disposition of a self-created patent, invention, model or design (whether or not patented), or secret formula or process would be ordinary in character. The election to treat musical compositions and copyrights in musical works as a capital asset would be repealed.

Individual Provisions:

14. **Ordinary Income Tax Rates** -The Bill would keep the same number of tax brackets (7 ranging from 10% to 37%):

Comparison of old versus new rates –

Single Taxpayers:

Income Level	Current Rate	Proposed New Rate
$0 - $9,525	10%	10%
$9,525 - $38,700	15%	12%
$38,700-$82,500	25%	22%
$82.500 - $93,700	25%	24%
$93,700-$157,500	28%	24%
$157,500-$195,450	28%	32%
$195,450 - $200,000	33%	32%
$200,000 - $424,950	33%	35%
$424,950-$426,700	35%	35%
$426,700 - $500,000	39.6%	35%
> $500,000	39.6%	37%

Married taxpayers filing joint return:

Income Level	Current Rate	Proposed New Rate
$0 - $19,050	10%	10%
$19,050-$77,400	15%	12%
$77,400-$156,150	25%	22%
$156,150-$165,000	28%	22%
$165,000-$237,950	28%	24%
$237,950-$315,000	33%	24%
$315,000-$400,000	33%	32%
$400,000-$424,950	33%	35%
$424,950-$480,050	35%	35%
$480,050-$600,000	39.6%	35%
> $600,000	39.6%	37%

The plan retains the "marriage penalty," within the 35% bracket, which ends at $500,000 for single taxpayers but at only $600,000 (rather than $1,000,000, or an amount twice the single bracket) for married couples.

15. **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.
16. **ACA (ObamaCare) Net Investment Income Taxes** – The 3.8% tax surcharge **has not been repealed!**
17. **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.**
18. **Deductions** –
    A. **Eliminated:** Alimony payments, Moving expenses, Personal casualty losses (except for Federal declared disasters), Unreimbursed employee expenses, Investment advisory fees, etc., and Tax preparation fees
    B. **Modified:** Mortgage Interest deductions limited to $750,000 acquisition of principal residence mortgages. State & Local Taxes are limited to $10,000. Medical expenses in excess of 7.5% of Adjusted Gross Income (10% after 2018)
    C. **Prepaid Taxes -** allowed for prepaid 2018 Real Estate Taxes but NOT for 2018 prepaid State & Local Income Taxes.
    D. **529 Education Plans** – The bill will now allow 529 plan to distribute $10,000 per student for qualifying expenses for public, private or religious elementary or seconday schools.

Estate & Gift Provisions.

19. **Exclusion** - The Act would double the base estate exclusion amount from $5 million (as indexed for inflation; $5.5 million for 2018 per taxpayer) to $11 million.
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 $600,000. In addition, the maximum rate of 37% (MFJ) is scheduled to start at $600,000 instead of $480,051. 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) in 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. **Non - Business property taxes** – Since individuals are on a cash basis, these taxes are deductible when paid. Prepayments of these taxes (paid before 1/1/18 may still be deductible), while prepayment of State & Local Income Taxes, if prepaid, are not deductible.

D. **Self-created property** – Property described in #13, 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 the final proposals that we consider to be of general interest to our readers and is not a complete discussion of the bill's contents. Please feel free to contact us with your specific questions.