Morrow & Co. LLC
CERTIFIED PUBLIC ACCOUNTANTS

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Congress passes biggest tax bill since 1986

On December 20, the House passed the reconciled tax reform bill, commonly called the “Tax Cuts and Jobs Act of 2017” (TCJA), which the Senate had passed the previous day. President Trump signed it today. It’s the most sweeping tax legislation since the Tax Reform Act of 1986.

The bill makes small reductions to income tax rates for most individual tax brackets, significantly reduces the income tax rate for corporations and eliminates the corporate alternative minimum tax (AMT). It also provides a new tax deduction for owners of pass-through entities and significantly increases individual AMT and estate tax exemptions, and it makes major changes related to the taxation of foreign income.

It’s not all good news for taxpayers, however. The TCJA also eliminates or limits many tax breaks, and much of the tax relief is only temporary.

Here is a quick rundown of some of the key changes affecting individual and business taxpayers. Except where noted, these changes are effective for tax years beginning ***after*** December 31, 2017.

Key changes affecting individuals

- Individual income tax rates are being lowered, ranging from 0 to 4 percentage points (depending on the bracket) to 10%, 12%, 22%, 24%, 32%, 35% and 37% — through 2025.
- Near doubling of the standard deduction to $24,000 (married couples filing jointly), $18,000 (heads of households), and $12,000 (singles and married couples filing separately) — through 2025.
- Elimination of personal exemptions — through 2025.
- Doubling of the child tax credit to $2,000 and other modifications intended to help more taxpayers benefit from the credit — through 2025.
- Elimination of the individual mandate under the Affordable Care Act requiring taxpayers not covered by a qualifying health plan to pay a penalty — *effective for months beginning after December 31, 2018.*
- Reduction of the adjusted gross income (AGI) threshold for the medical expense deduction to 7.5% for regular and AMT purposes — *for 2017 and 2018*.

Last-Minute Year-End Moves in Light of Tax Bill

Also keep in mind that, as a result of the TCJA, you may have some last-minute year-end 2017 tax planning opportunities — but quick action (before January 1, 2018) will be needed. The second part of this newsletter is dedicated to last-minute planning opportunities. If you have questions about what you can do before year end to maximize your savings, or you’d like to learn more about how these and other tax law changes will affect you in 2018 and beyond, please contact us.

- New $10,000 limit on the deduction for state and local taxes (on a combined basis for property and income taxes; $5,000 for separate filers) — through 2025.
- Reduction to the mortgage debt limit for the home mortgage interest deduction, to $750,000 ($375,000 for separate filers), with certain exceptions — through 2025.
- Elimination of the deduction for interest on home equity debt — through 2025.
- Elimination of the personal casualty and theft loss deduction (with an exception for federally declared disasters) — through 2025.
- Elimination of miscellaneous itemized deductions subject to the 2% floor (such as certain investment expenses, professional fees and unreimbursed employee business expenses) — through 2025.
- Elimination of the AGI-based reduction of certain itemized deductions — through 2025.
- Elimination of the moving expense deduction (with an exception for members of the military in certain circumstances) — through 2025.
- Expansion of tax-free Section 529 plan distributions to include those used to pay qualifying elementary and secondary school expenses, up to $10,000 per student per tax year.
- AMT exemption increase, to $109,400 for joint filers, $70,300 for singles and heads of households, and $54,700 for separate filers — through 2025.
- Doubling of the gift and estate tax exemptions, to $10 million (expected to be $11.2 million for 2018 with inflation indexing) — through 2025.

Key changes affecting businesses

- Replacement of graduated corporate tax rates ranging from 15% to 35% with a **flat** corporate rate of 21%. This is actually a tax increase for lower income taxpayers.
- Repeal of the 20% corporate AMT.
- New 20% qualified business income deduction for owners of flow-through entities (such as partnerships, limited liability companies and S corporations) and sole proprietorships — through 2025 with certain limitations in place. The deduction, in general, is limited to the greater of 50% of W-2 wages, or 25% of W-2 wages plus 2.5% of the unadjusted basis of property used in the production of income. The W-2 limitations do not apply if you earn less than $157,500 (single) or $315,000 (married filing joint). Certain "personal service businesses" (lawyers, doctors, etc.) are subject for phaseout of the deduction, unless their taxable income is less than $157,500 (single) or $315,000 (married filing joint).
- Doubling of bonus depreciation to 100% and expansion of qualified assets to include used assets — *effective for assets acquired and placed in service after September 27, 2017, and before January 1, 2023.*
- Doubling of the Section 179 expensing limit to $1 million and an increase of the expensing phaseout threshold to $2.5 million.
- New disallowance of deductions for net interest expense in excess of 30% of the business's adjusted taxable income (exceptions apply), if average receipts are greater than $25 million.
- New limits on net operating loss (NOL) deductions. NOLs will no longer be allowed to be carried back. NOLs will only be allowed to be carried forward and the NOL deduction will be limited to 80% of taxable income.

- Elimination of the Section 199 deduction, also commonly referred to as the domestic production activities deduction or manufacturers' deduction *— effective for tax years beginning after December 31, 2017, for noncorporate taxpayers and for tax years beginning after December 31, 2018, for C corporation taxpayers.*
- New rule limiting like-kind exchanges to real property that is *not* held primarily for sale.
- New tax credit for employer-paid family and medical leave — through 2019.
- New limitations on excessive employee compensation.
- New limitations on deductions for employee fringe benefits, such as entertainment and, in certain circumstances, meals and transportation. In general, entertainment expenses are no longer deductible. The deduction for meals that are provided by the employer to employees at an employer-operated eating facility for the convenience of the employer will now be limited to 50%, instead of fully deductible.

We've only briefly covered some of the highlights of the TCJA provisions here. There are many additional rules and limits that apply, and the law includes many additional provisions.

Year-end planning opportunities still available

Here are a few thoughts to consider for last minute planning techniques –

Disappearing or reduced deductions, larger standard deduction. Beginning next year, the Tax Cuts and Jobs Act suspends or reduces many popular tax deductions in exchange for a larger standard deduction. Here's what you can do about this right now:

- Individuals (as opposed to businesses) will only be able to claim an itemized deduction of up to $10,000 ($5,000 for a married taxpayer filing a separate return) for the total of (1) state and local property taxes; and (2) state and local income taxes. To avoid this limitation, pay the last installment of estimated state and local taxes for 2017 no later than December 31, 2017, rather than on the 2018 due date, but don't prepay 2018 state income taxes in 2017 – Congress says such a prepayment won't be deductible in 2017. However, Congress only forbade prepayments for state income taxes, not property taxes, so a prepayment on or before December 31, 2017, of a 2018 property tax installment is apparently okay.
- The itemized deduction for charitable contributions won't be chopped, but because most other itemized deductions will be eliminated in exchange for a larger standard deduction (e.g., $24,000 for joint filers), charitable contributions after 2017 may not yield a tax benefit for many because they won't be able to itemize deductions. If you think you will fall in this category, consider accelerating some charitable giving into 2017.
- The new law temporarily boosts itemized deductions for medical expenses. For 2017 and 2018 these expenses can be claimed as itemized deductions to the extent they exceed a floor equal to 7.5% of your adjusted gross income (AGI). Before the new law, the floor was 10% of AGI, except for 2017 it was 7.5% of AGI for age-65-or-older taxpayers. But keep in mind that next year many individuals will have to claim the standard deduction because many itemized deductions have been eliminated. If you won't be able to itemize deductions after this year, but will be able to do so this year, consider accelerating "discretionary" medical expenses into this year. For example, before the end of the year, get new glasses or contacts.

Other year-end strategies. Here are some other last minute moves that can save tax dollars in view of the new tax law:

- The new law substantially increases the alternative minimum tax (AMT) exemption amount, beginning next year. There may be steps you can take now to take advantage of that increase. For example, the exercise of an incentive stock option (ISO) can result in AMT complications. So, if you hold any ISOs, it may be wise to postpone exercising them until next year, and, for various deductions, e.g., depreciation and the investment interest expense deduction, the deduction will be curtailed if you are subject to the AMT. If the higher 2018 AMT exemption means you won't be subject to the 2018 AMT, it may be worthwhile, via tax elections or postponed transactions, to push such deductions into 2018.
- Like-kind exchanges are a popular way to avoid current tax on the appreciation of an asset, but after December 31, 2017, such swaps will be possible only if they involve real estate that isn't held primarily for sale. So if you are considering a like-kind swap of other types of property, do so before year-end. The new law says the old, far more liberal like-kind exchange rules will continue to apply to exchanges of personal property if you either dispose of the relinquished property or acquire the replacement property on or before December 31, 2017.
- For decades, businesses have been able to deduct 50% of the cost of entertainment directly related to or associated with the active conduct of a business. For example, if you take a client to a nightclub after a business meeting, you can deduct 50% of the cost if strict substantiation requirements are met, but under the new law, for amounts paid or incurred after December 31, 2017, there's no deduction for such expenses. So if you've been thinking of entertaining clients and business associates, do so before year-end.
- Under current rules, alimony payments generally are an above-the line deduction for the payor and included in the income of the payee. Under the new law, alimony payments aren't deductible by the payor or includible in the income of the payee, generally effective for any divorce decree or separation agreement executed after 2017.
- The new law suspends the deduction for moving expenses after 2017 (except for certain members of the Armed Forces), and also suspends the tax-free reimbursement of employment-related moving expenses. So if you're in the midst of a job-related move, try to incur your deductible moving expenses before year-end, or if the move is connected with a new job and you're getting reimbursed by your new employer, press for a reimbursement to be made to you before year-end.
- Under current law, various employee business expenses, e.g., employee home office expenses, are deductible as itemized deductions if those expenses plus certain other expenses exceed 2% of adjusted gross income. The new law suspends the deduction for employee business expenses paid after 2017. So, we should determine whether paying additional employee business expenses in 2017, that you would otherwise pay in 2018, would provide you with an additional 2017 tax benefit. Also, now would be a good time to talk to your employer about changing your compensation arrangement—for example, your employer reimbursing you for the types of employee business expenses that you have been paying yourself up to now, and lowering your salary by an amount that approximates those expenses. In most cases, such reimbursements would not be subject to tax.

Please keep in mind that I've described only some of the year-end moves that should be considered in light of the new tax law. If you would like more details about any aspect of how the new law may affect you, please do not hesitate to call.