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Tax Reform or Tax Calamity?

A Closer Look into the Tax Cuts and Jobs Act

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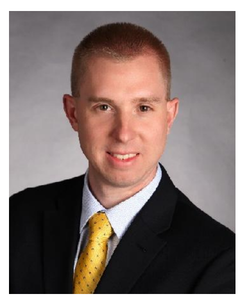

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A Closer Look into the Tax Cuts and Jobs Act

INTRODUCTION

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Tax Reform or Tax Calamity?

INTRODUCTION

- ***Tax Cuts and Jobs Act passed on December 20, 2017, enacted on December 22, 2017***
  - This tax reform legislation was based on numerous attempts over more than 20 years to reform the U.S. Tax Code, over many Presidential administrations and Congressional sessions
    - The most recent attempts are based on the Tax Reform Act of 2014, introduced by Dave Camp, Chair / House Ways and Means Committee
    - The core elements and goals of the 2015 drafted legislation set forth in the *Unified Framework for Fixing Our Broken Tax Code* (Sept 27, 2017)

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- ***Uniform Framework for Fixing Our Broken Tax Code***
  - Goals of proposed legislation
    - Tax relief for middle-class families
    - Simplicity of "postcard" tax filing for the vast majority of Americans
    - Tax relief for businesses, especially small businesses
    - Ending incentives for shipping jobs, capital, and tax revenue overseas
    - Broadening tax base and providing greater fairness for all Americans by closing special interest tax breaks and loopholes

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- ***How the new law will work to achieve goals for individuals***
  - Reduces individual marginal income tax rates
  - Expands standard deductions
  - Enhances the child tax credit
  - Creates greater simplicity as a result of eliminating itemized deductions for many
  - Provides aid to middle class families

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- ***How the new law will work to achieve goals for businesses***
  - Significantly reduces corporate marginal income tax rates
  - Expands capital asset acquisition benefits through expanded bonus depreciation and Section 179 expensing
  - Allows a 20% deduction for combined pass-through income at individual equity owner level
  - Eliminates the corporation Alternative Minimum Tax

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INTRODUCTION

- ***How the new law will work to achieve goals for businesses***
  - Simplifies certain cash basis accounting rules for small businesses
  - Reframes the international income tax regime to afford the United States and companies operating within our borders an opportunity to do so on a more competitive basis

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- ***Will the Tax Cuts and Jobs Act Work?***
  - The verdict on the effectiveness of the new law will take years, and perhaps decades, to discern
  - Recent news, however, clearly illustrates that America's business community is embracing the changes made by the TCJA
  - International companies have made numerous announcements regarding proposed uses of the tax savings afforded by the TCJA
  - Small businesses are looking to capitalize on expected lower tax obligations, as well

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- ***Note that today's program is intended to familiarize participants with the key provisions of the Tax Cuts and Jobs Act***

  II. Impact on Families and Individuals
  III. Impact on Pass-Through Entities
  IV. Impact on Businesses
  V. Impact on International Taxation
  VI. Impact on Qualified Retirement Plans
  VII. Impact on Exempt Organizations
  VIII. Concluding Thoughts and Practical Considerations

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INTRODUCTION

- ***Care should be taken to assimilate the information covered today into your own tax situations, to the degree possible!***
- ***While GYF will be carefully considering the impact of the TCJA on our clients' tax liabilities for 2018 and beyond, note that specific tax planning will be necessary to optimize the tax benefits afforded by the new legislation***

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A Closer Look into the Tax Cuts and Jobs Act

IMPACT ON FAMILIES AND INDIVIDUALS

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- ***Note that all individual provisions are TEMPORARY***
- ***For tax years beginning in 2026, the TCJA provisions sunset and pre-TCJA laws kick back in***

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Primary Changes for Individual Taxpayers***
  - Post-AGI changes:
    - Standard deductions have nearly doubled
    - Personal and dependency exemptions are gone
    - Itemized deductions have been substantially changed
    - Child Tax Credits have doubled (for some)
    - 20% deduction for certain pass-through income
  - Tax Rate and Bracket Changes

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Marginal Income Tax Rates***
  - Rates and brackets adjusted down
  - 10%, 12%, 22%, 24%, 32%, 35%, 37% NEW
  - 10%, 15%, 25%, 28%, 33%, 35%, 39.6% OLD

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Primary Changes for Individual Taxpayers***

Simple examples of the rate changes:

	2017	2018	Savings
Married Filing joint with TI of $75,000	$ 10,321	$ 8,619	$ 1,702
Married Filing joint with TI of $100,000	16,478	13,879	2,599
Married Filing joint with TI of $250,000	57, 717	48,579	9,138
Married Filing joint with TI of $750,000	242,231	216,879	25,352

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- ***Changes to the Standard Deduction***
  - Amount by which a taxpayer's adjusted gross income (AGI) may be decreased if he or she does not itemize allowable deductions
    - Generally, the standard deduction is used only if taxpayer does not have enough itemized deductions to exceed a particular year's standard deduction amount
  - Standard deduction nearly doubled under the TCJA

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to the Standard Deduction***

	Old Law	New Law
Single	$ 6,500	$ 12,000
Head of Household	9,550	18,000
Married filing joint	13,000	24,000

- Change will benefit those who would not have been itemizing
- The increased standard deduction will substantially reduce the number of taxpayers who itemize

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Deduction for Personal and Dependency Exemptions Repeal***
  - The TCJA temporarily repeals the deduction for personal and dependency exemptions for tax years beginning after December 31, 2017, and before January 1, 2026
  - Adds new layer of complexity to ensuring that an employee's federal income tax withholding on wages is appropriate

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Expansion of the Child Tax Credit***
  - Increased and expanded to address negative outcome created by the repeal of deductions for personal and dependency exemptions
  - Previously, taxpayer could claim up to $1,000 for each qualifying child, now the credit is $2,000 and the related phase-out thresholds are increased

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Expansion of the Child Tax Credit***
  - Married filing jointly threshold is $400,000 and threshold for all other taxpayers was increased to $200,000

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Prior to TCJA, the primary Itemized Deductions consisted of:***

Medical expenses	Threshold reduced
State and local taxes	Deduction severely limited
Mortgage and home equity interest	Deduction limited and eliminated
Charitable donations	Limitations reduced
Miscellaneous itemized Deductions	Totally eliminated

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Modifications to the Itemized Deduction for State and Local Taxes (SALT)
    - New law retains individual taxpayer deduction for amounts paid (up to $10,000) in any combination of state and local and/or property taxes
    - Allows for taxpayers to use sales taxes to compute the $10,000 maximum deduction in states where there is no income tax
    - This limitation can have a significant impact on pass-through owners

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2017 LAW EXAMPLE – SALT DEDUCTIONS

	Don	Bob
Compensation	$ 150,000	$ 150,000
Spouse compensation	10,000	10,000
Itemized deductions:	–	–
State and local taxes	(4,000)	(8,000)
Property taxes	(10,000)	(15,000)
Mortgage interest	(10,000)	(19,000)
Exemptions	(8,100)	(8,100)
Taxable income	$ 127,900	$ 109,900
Tax	$ 23,453	$ 18,953

Difference = $ 4,500

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2018 LAW EXAMPLE – SALT DEDUCTIONS

	Don	**Bob**
Compensation	$ 150,000	$ 150,000
Spouse	10,000	10,000
Standard deduction	(24,000)	(24,000)
Taxable income	$ 136,000	$ 136,000
Net federal tax	$ 21,799	$ 21,799
	Difference = $0	
Year-to-Year Delta	($ 1,654)	$ 2,846

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Modifications to the Itemized Deduction for State and Local Taxes (SALT)
    - Prepaid 2018 taxes that were paid in 2017 are not deductible in 2017
    - Several lawmakers are challenging this ruling
    - Several states are establishing “programs” to bypass this provision

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Modifications to the Itemized Deduction for Mortgage Interest
    - "Qualified residence interest" remains deductible, but there are limitations
    - A "Qualified residence" includes a principal residence and one other residence (can be a vacation home)

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Modifications to the Itemized Deduction for Mortgage Interest
    - The TCJA makes two substantial changes to prior law
      - Modifies the amount of home acquisition indebtedness on which interest deduction can be permitted to $750,000, and
      - Modifies repeals the deduction for interest on certain home equity loans

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Repeal of the Miscellaneous Itemized Deductions
    - Constituted a way for taxpayers to take deductions for expenses associated with their activities conducted as an employee as well as those costs incurred during the production of income
    - Eliminates ability to deduct
      - Certain investment fees, tax prep and planning fees, employee related costs, etc.

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Reduction of the Limitation on the Medical Expense Deduction
    - Federal government provides a medical expense deduction as part of the Schedule A, Itemized Deduction calculation
      - The TCJA decreased the 10% threshold to 7.5% across the board, allowing for the potential deduction of a larger portion of those medical expenses

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- ***Changes to Itemized Deductions***
  - Charitable Contributions
    - Two changes made to standard requirement/limitations when taking a deduction regarding charitable donations
      - Deductions relating to contributions to colleges/universities in exchange for the right to purchase tickets etc. and deduct 80% of the contribution was eliminated in the TCJA
      - Additional documentation is needed to support charitable contributions

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Repeal of Itemized Deduction Limitation
    - TCJA temporarily repeals phase-out on the overall limitation on itemized deductions, applicable to tax years beginning after December 31, 2017 and before January 1, 2026

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Itemized Deductions***
  - Summary of the changes related to Itemized Deductions:
    - The increase in the standard deduction will reduce the number of itemized deduction filers
    - The reduction of itemized deductions will lead to higher taxable income for higher earners
    - Careful planning is critical, especially in 2018, as the new laws are interpreted
    - See the example on page 36

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Alternative Minimum Tax (AMT)***
  - NOT repealed!
  - The TCJA has modified AMT with expanded exemption amounts and phase-out thresholds – fewer people will be in AMT
  - AMT is imposed on individuals, estates, and/or trusts

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Other Miscellaneous Changes***
  - Capital Gains Rates and Qualified Dividends Rates:
    - Remain largely unchanged, max of 20% gains resulting from most capital transactions and qualified dividend income
    - Break points are important
  - Net Investment Income Tax (NIIT)
    - Law DID NOT repeal the taxes imposed by the Obamacare legislation

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes to Alimony and Similar Payments***
  - Repeal of the alimony deduction is only effective for divorce and separation agreements entered into after 2018 and before 2019 if the agreement is modified to include language that adopts new rules
  - Payments in question (does not include child support) must have been subject to a legal agreement (with certain stipulations) between two parties to qualify for tax treatment
    - Must be legally separated, filing separate returns and not living in the same household

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Expanded Exclusionary Options to Related Student Loan Indebtedness***
- ***Other Changes to Education Tax Benefits***
  - New law provides an expansion of the use and applicability of funds saved within a "qualified tuition plan" or 529 plan

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Kiddie Tax: invokes rules to simplify tax on child's investment and other unearned income***
- ***Elimination of Individual Mandate***
- ***Changes to the Moving Expense Deduction***

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IMPACT ON FAMILIES AND INDIVIDUALS

- ***Changes in the Estate, Gift and Generation-Skipping Transfer Tax Exclusions***
  - The TCJA doubles dollar amount of property that can be transferred in a lifetime from $5M to $10M
  - This increase allows taxpayers who previously fully utilized their lifetime exclusions to gift additional assets to junior-generation family to significantly add to previously made transfers

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IMPACT ON PASS-THROUGH ENTITIES

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IMPACT ON PASS-THROUGH ENTITIES

- ***Individual taxpayers who receive business income from a pass-through business entity are taxed on that income at the regular individual income tax rates***
- ***When additional taxes are factored in, pass-through business income can often be subjected to historical combined rates of nearly 50% under prior tax law***
- ***Since equity owners must pay tax on their shares on their individual tax returns, businesses often make cash distributions to cover the owners' tax obligations associated with this income***

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IMPACT ON PASS-THROUGH ENTITIES

- ***The TCJA aims to reduce taxation for pass-through businesses by creating a new pass-through deduction for qualified taxpayers***
- ***Qualified Business Income (QBI) Deduction***
  - Effective for tax years beginning after December 31, 2017 and before January 1, 2026
  - Taxpayer may deduct up to 20% of QBI from pass-through entity
  - Deduction is available only at the individual shareholder, partner, member or sole proprietor level

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IMPACT ON PASS-THROUGH ENTITIES

- ***Limitations on the QBI Deduction***
  - Subject to defined income thresholds and may be disallowed for certain service trades and businesses
  - Not allowed in determining individual's AGI
  - Cannot be taken as an itemized deduction, but is available for taxpayers who choose to itemize deductions, as well as for those who claim the expanded standard deduction
  - Estates and trusts also qualify to take the QBI deduction

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IMPACT ON PASS-THROUGH ENTITIES

- ***Mechanics of the QBI Deduction***
  - An individual can claim the deduction for the sum of:
    - the *lesser* of:
      - the "combined *qualified business income amount,*" or 20% of the excess of the taxpayer's taxable income, over the sum of:
        (i) the taxpayer's net capital gain, and
        (ii) the taxpayer's aggregate qualified cooperative dividends
    - PLUS, the *lesser* of:
      - 20% of the taxpayer's aggregate qualified cooperative dividends; or
      - the taxpayer's taxable income, minus the taxpayer's net capital gain

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- ***Mechanics of the QBI Deduction***
  - Deduction Limitations
    - Greater of:
      - the "50% of W-2 wages paid by the business," or "the sum of 25% of the W-2 wages paid *plus* 2.5% of the unadjusted basis of certain property the business use to produce qualified income
    - This limit may be phased-in or eliminated if the taxpayer's income meets or exceeds certain threshold levels

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IMPACT ON PASS-THROUGH ENTITIES

- ***Mechanics of the QBI Deduction***
  - Deduction Limitations Exemption
    - The W-2 wages/qualified property limits do NOT apply if the taxpayer's taxable income for any tax year is equal to, or less than, $157,500 for non-joint filers or $315,000 for taxpayers filing a joint return
    - For taxpayers exceeding these limits, the W-2 wages/qualified property limits are phased-in or eliminated
    - Phase-in range is $157,501 to $207,500 for non-joint filers, and $315,001 to $415,000 for taxpayers filing a joint return

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DETERMINATION OF THE QBI DEDUCTION

Step 1: Determine QBI and QBI Deduction

Qualified Business Income (Schedule K-1 Income)	$	250,000
Applicable Statutory Deduction Percentage		20%
Tentative QBI Deduction (subject to limitation)	$	50,000

Step 2: Determine Taxable Income (Excluding QBI Deduction)

Wages	$	100,000
Ordinary Income from Qualified Business		250,000
Capital Gain		15,000
Adjusted Gross Income		365,000
Deductions		(50,000)
Taxable Income (before QBI Deduction)	$	315,000

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DETERMINATION OF THE QBI DEDUCTION

Step 3: Determine If Limitation Applies

A. Taxable Income in excess of $315,000 Floor	$	-
B. Limitation Phase-in Range: $315,001 - $415,000	$	100,000
Limitation in Phase-in Range	$	-

Step 4: Determine Taxable Income

Taxable Income (before QBI Deduction)	$	315,000
QBI Deduction – Final		(50,000)
Taxable Income (after QBI Deduction)	$	265,000

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IMPACT ON PASS-THROUGH ENTITIES

- ***Factoring in the W-2 Wages/Qualified Property Limitation***
  - Intended to restrict the benefit of the QBI deduction to pass-through entities that invest in people and/or equipment (to help companies that conduct true operating businesses)
  - Exceptions for individual taxpayers with lower taxable incomes
  - Thresholds allow limit to be phased in as income grows

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APPLICATION OF THE W-2 WAGES/QUALIFIED PROPERTY LIMIT

Step 1: Calculate Form W-2 Wage Limit:					
Form W-2 Wages x 50%	$ 40,000	x	50.0%	=	$ 20,000
Step 2: Calculate Combined Wage/Qualified Property Limit:					
Sum of:					
Form W-2 Wages x 25%	$ 40,000	x	25.0%	=	$ 10,000
Qualified Property x 2.5%	$ 200,000	x	2.5%	=	$ 5,000
Combined					$ 15,000
Step 3: Determine W-2 Wages/Qualified Property Limit:					
	Step 1				Step 2
Greater of Step 1 and Step 2	$ 20,000		>		$ 15,000

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DETERMINATION OF QBI DEDUCTION WITH LIMITATION

Step 1: Determine QBI and QBI Deduction						
Qualified Business Income x 20%	$ 250,000	x		20.0%	=	$ 50,000
Step 2: Calculate Combined Wage/Qualified Property Limit*						
Form W-2 Wages x 50%	$ 40,000	x		50.0%	=	$ 20,000
Step 3: Determine [preliminary] Limitation Amount	Step 1			Step 2		
Step 1 – Step 2	$ 50,000	–	$	20,000	=	$ 30,000
Step 4: Determine Phase-in Percentage						
Taxable Income in Excess of $315,000 Floor =	$ 50,000	/	$	100,000	=	50%
	[Phase-in Range ($315,000 - $415,000)]					
Step 5: Determine Phase-in of Limitation	Step 3			Step 4		
Step 3 x Step 4	$ 30,000	x		50%	=	$ 15,000
Step 6: Determine Pass-through Deduction	Step 3			Step 5		
Step 1 – Step 5	$ 50,000	–	$	15,000	=	$ 35,000

** This example excludes any consideration of the wages/qualified property limitation.*

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IMPACT ON PASS-THROUGH ENTITIES

- ***Excluding Specified Service Trades or Businesses***
  - Eliminates many businesses providing professional services
    - Excludes accounting, financial consulting and law firms, among others
    - Does not exclude engineering and architectural firms
    - Exceptions for individual taxpayers with lower taxable incomes
  - Thresholds allow smaller service businesses to take advantage of the QBI deduction (phased-in based on taxable income)

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DETERMINATION OF QBI DEDUCTION WITH LIMITATION FOR A SPECIFIED SERVICE BUSINESS

Step 1: Determine Preliminary QBI and QBI Deduction									
Qualified Business Income x 20%	$	177,500	x		20.0%	=	$	35,500
Step 2: Calculate Combined Wage/Qualified Property Limit*								
Form W-2 Wages x 50%	$	80,000	x		50.0%	=	$	40,000
Step 3: Determine Phase-in Percentage								
Taxable Income in Excess of $157,500 Floor =	$	20,000	/	$	50,000	=		40%
	[Phase-in Range ($157,500 – $207,500)]							
Step 4: Determine Includible Combined QBI Deduction								
	100% – Step 3			Step 1				
(100% – Step 3 Percentage) x Step 1		60%	x	$	35,500	=	$	21,300
Step 5: Determine Includible Wage/Qualified Property Limit								
	100% – Step 3			Step 2				
(100% – Step 3 Percentage) x Step 2		60%	x	$	40,000	=	$	24,000
Step 6: Determine Pass-through Deduction								
	Step 4			Step 5				
Lesser of Step 4 or Step 5	$	$\boxed{21,300}$	<	$	24,000			

** This example excludes any consideration of the wages/qualified property limitation.*

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IMPACT ON PASS-THROUGH ENTITIES

- ***Calculating QBI Deduction for Multiple Businesses***
  – QBI is net amount of all (i.e., "combined") qualified items of income, gain, deduction and loss from all taxpayer's businesses
  – Net losses can be carried over to the next tax year

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DETERMINATION OF QBI AND QBI DEDUCTION FROM MULTIPLE BUSINESSES

Step 1: Determine 2018 Qualified Business Income (Loss)							
- 2018 Qualified Business Income (Business A)	$	200,000					
- 2018 Qualified Business Income (Business B)	$	(250,000)					
Qualified Business Loss	$	(50,000)					
Step 2: Determine 2019 QBI Deduction – Prior to Loss Carryover							
- 2019 Qualified Business Income (Business A)	$	100,000					
- 2019 Qualified Business Income (Business B)	$	50,000					
	$	150,000	x	20.0%	=	$	30,000
Step 3: Determine 2019 QBI Deduction in Consideration of Carryover							
Qualified Business Income for 2019	$	150,000	x	20.0%	=	$	30,000
Less:							
Carryover of Qualified Business Loss from 2018	$	(50,000)	x	20.0%	=	$	(10,000)
Final Qualified Business Deduction for 2019						$	20,000

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DETERMINATION OF QBI AND QBI DEDUCTION FROM MULTIPLE BUSINESSES (WITH LOSS CARRYOVER)

Step 1: Determine 2019 QBI Deduction – Prior to Loss Carryover							
Qualified Business Income x 20%							
- 2019 Qualified Business Income (James)	$	150,000	x	20.0%	=	$	30,000
- 2019 Qualified Business Income (Susan)*	$	(50,000)	x	20.0%	=		(10,000)
	$	100,000			=	$	20,000
** The loss works to produce a reduction to the combined deduction.*							
Step 2: Determine 2019 QBI Deduction – with Loss Carryover							
Qualified Business Income for 2019	$	100,000	x	20.0%	=	$	20,000
Less:							
Carryover of Qualified Business Loss from 2018	$	(30,000)	x	20.0%	=	$	(6,000)
							14,000

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IMPACT ON PASS-THROUGH ENTITIES

- ***Individual-Level Deduction***
  - QBI deduction is applied at the shareholder or partner level
  - Individual taxpayers must take pro rata or allocable shares of QBI of the entity into account
  - Similar adjustment required for shares of W-2 wages
  - Will complicate pass-through entity tax filing and K-1 reporting in order to accurately reflect all necessary information

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ECONOMIC IMPACT OF THE QBI DEDUCTION

Step 1: Determine QBI and QBI Deduction

Qualified Business Income x 20%	$	1,000,000	x	20.0%	=	$	200,000

Step 2: Determine Taxable Income (Excluding QBI Deduction)

		2017		2018		Difference
Wages	$	300,000	$	300,000	$	-
Ordinary Income from Qualified Business		1,000,000		1,000,000		-
Adjusted Gross Income		1,300,000		1,300,000		-
Deductions		(100,000)		(100,000)		-
Taxable Income (before QBI Deduction)	$	1,200,000	$	1,200,000	$	-

Step 3: Determine Taxable Income

		2017		2018		Difference
Taxable Income (before QBI Deduction)	$	1,200,000	$	1,200,000	$	-
QBI Deduction		n/a		(200,000)		(200,000)
Taxable Income (after QBI Deduction)	$	1,200,000	$	1,000,000	$	(200,000)

Step 4: Determine Federal Tax Liability

		2017		2018		Difference
Federal Income Tax Obligation	$	420,431	$	309,379	$	(111,052)

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IMPACT ON PASS-THROUGH ENTITIES

- ***Summary Considerations Related to the QBI Deduction***
  - Taxable income below the thresholds should allow for a deduction at 20% of QBI without limitation
  - If the results of the W-2 wages/qualified property test exceed 20% of QBI, all owners should be able to take the QBI deduction at 20% of QBI (in consideration of other pass-through entities)

    (Unless the pass-through entity constitutes a Specified Service Trade or Business)

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IMPACT ON PASS-THROUGH ENTITIES

- ***Summary Considerations Related to the QBI Deduction***
  - If the pass-through entity results fail to meet the W-2 wages/qualified property test, the taxpayer will have to work through the W-2 wages/qualified property limits calculations to determine the amount of the QBI deduction

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IMPACT ON PASS-THROUGH ENTITIES

- ***Reconciling the Business Marginal Tax Rates***
  - The QBI deduction reduces the effective marginal tax rates on the income of pass-through entities to be roughly equivalent (after considering the second layer of tax) to the flat tax and dividends tax allowed for businesses organized as C corporations
  - Pass-through owners receive tax-free distributions of earnings from businesses; whereas, C corporations are subject to a "second layer of tax" on earnings distributed as dividends

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IMPACT ON PASS-THROUGH ENTITIES

- ***Should Businesses Consider Changing Entity Structure?***
  - Effects of state taxes must be considered
  - Timing of owner exit also influences decision
  - All specific facts and circumstances must be carefully analyzed

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IMPACT ON PASS-THROUGH ENTITIES

- ***Issues Affecting Partnerships***
  - Required holding period for long-term capital gains for partners with *carried* interests
  - Basis limitation on partner losses, applicability of basis rules to charitable contributions and foreign taxes
  - Treatment of sale/exchange of partnership interests by foreign persons
  - Technical termination of partnerships

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IMPACT ON PASS-THROUGH ENTITIES

- ***Issues Relating to Electing Small Business Trusts***
  - Qualified beneficiary expanded to include a nonresident alien individual in an ESBT
  - Does not allow that same individual to qualify as a shareholder in an S corporation
  - Charitable contribution deduction in an ESBT is not calculated under normal trust rules, but under rules applicable to individuals

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IMPACT ON PASS-THROUGH ENTITIES

- ***S Corporation Conversions to C Corporations***
  - Special rules exist for distributions during post-termination transition period
  - Accumulated adjustment account determines the tax effect of distributions
  - Adjustments must be made if accounting method changes

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Tax Reform or Tax Calamity?

A Closer Look into the Tax Cuts and Jobs Act

IMPACT ON BUSINESSES

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IMPACT ON BUSINESSES

- ***Primary goal was to provide stimulus for the U.S. economy, level the playing field for U.S. corporations in international commerce and encourage companies to keep operations in the United States***
  - Permanently reduces corporate tax rate
  - Provides favorable changes to deductions and tax credits
  - Permanently repeals corporate AMT
  - Switches to territorial tax system

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IMPACT ON BUSINESSES

- ***Corporate Income Tax Rate Reduction***
  - Permanently reduced to a 21% flat rate (graduated rates ranging from 15% to 35% under prior law)
  - Effective for tax years beginning after December 31, 2017
  - Proration of rates under Section 15 for tax years spanning effective dates of change (fiscal year corporations)
    - Some question as to whether these rules even apply to the corporate rate

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IMPACT ON BUSINESSES

- ***AMT for Corporations***
  - Permanently eliminated for tax years beginning after December 31, 2017
  - Repeal serves to reduce complexity of Internal Revenue Code
  - Portion of unused minimum tax credit remains refundable for tax years 2018 through 2021

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IMPACT ON BUSINESSES

- ***Business Interest Limitation***
  - Significantly changes traditional deduction for business interest
  - Limited to sum of business income, floor plan financing interest and 30% of taxpayer's "adjusted taxable income"
  - Exception for small businesses ($25 million gross receipts test)
  - "Real Property Trade or Businesses" can elect to be excluded from the limitation (once made, election is irrevocable) – trade-off is to forgo bonus depreciation

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IMPACT ON BUSINESSES

- ***Business Interest Limitation***
  - Amount of interest not allowed as deduction may be carried forward indefinitely (restrictions apply for pass-through entities)
  - Applies to partnerships and S corps at "pass-through entity" level
  - Disallowed interest (for pass-through entities) cannot be carried forward; it is treated as "allocated excess business interest" to be dealt with at the partner or shareholder level

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IMPACT ON BUSINESSES

- ***Simplified Accounting Rules for Small Businesses***
  - More taxpayers able to use the cash method of accounting
  - Many "small businesses" (<$25 million gross receipts) will not be required to account for inventories nor apply UNICAP rules
  - Effective for tax years beginning after December 31, 2017
  - Likely to simplify recordkeeping and tax compliance
  - Taxpayers must apply for a change in accounting method

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IMPACT ON BUSINESSES

- ***Changes to Bonus Depreciation Rules***
  - Bonus depreciation rate increases to 100% for property placed in service after September 27, 2017 and before January 1, 2023
  - The rate will phase down each year until it expires after 2026
  - Removes "qualified improvement property" as separate category
  - Eliminates the requirement that only "new" property is eligible
  - Special rules apply for certain industries and businesses

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IMPACT ON BUSINESSES

- ***Section 179 Expensing***
  - Permanently increases dollar limitation to $1 million and investment limitation to $2.5 million
  - Effective for tax years beginning after December 31, 2017
  - Expands definition of eligible "qualified real property"

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IMPACT ON BUSINESSES

- ***Changes to Business Deductions***
  - Net Operating Losses (NOLs): changes applicable for NOLs *arising* in tax years beginning after December 31, 2017
    - No longer allowed to be carried back (with limited exceptions)
    - Can be carried forward indefinitely (20-year limitation repealed)
    - Amount of future income that can be offset is reduced from 100% to 80% for losses occurring in tax years beginning after December 31, 2017

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IMPACT ON BUSINESSES

- ***Changes to Business Deductions***
  - DPAD: the 9% deduction is repealed for tax years after 2017
  - Entertainment, Meals & Commuting Benefits: most expenses are no longer deductible by the employer (effective dates vary)
  - Research & Experimentation: deduction remains, but reduced accounting options, effective for expenses incurred after 2021
  - Employee Achievement Awards: rules clarified for deduction

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IMPACT ON BUSINESSES

- ***Changes to Business Credits***
  - Paid Family and Medical Leave: new credit created for wages paid in tax years 2018 and 2019; employers can claim 12.5% of wages paid to employees on leave under FMLA
  - Rehabilitation Credit: changes made to how the 20% QRE credit is claimed; the 10% QRE credit is repealed

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IMPACT ON BUSINESSES

- ***Additional Business Changes Not Addressed in Today's Program***
  - Treatment of Like-Kind Exchanges Limited to Real Property Exchanges
  - Excise Tax Rates on Beer and Distilled Spirits Reduced
  - Wine Excise Tax Credit Expanded
  - Aircraft Management Services Excluded from the Excise Tax on the Air Transportation of Passengers

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IMPACT ON BUSINESSES

- ***Additional Business Changes Not Addressed in Today's Program***
  - Depreciation Deductions for "Luxury" Cars Increased Significantly for Property Placed in Service after 2017
  - Computers and Related Peripheral Equipment Are No Longer Classified as "Listed Property"
  - Research and Experimental Expenditures Must Be Amortized over 60 Months

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A Closer Look into the Tax Cuts and Jobs Act

IMPACT ON INTERNATIONAL TAXATION

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IMPACT ON INTERNATIONAL TAXATION

- ***Change from Worldwide to Territorial Tax Regime***
- ***100% Foreign Dividend Participation Exemption***
  - To offset inclusion of foreign earnings on U.S. tax return
  - 100% deduction allowed for "foreign-source portion" of dividends from "specified 10%-owned foreign corporation"

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IMPACT ON INTERNATIONAL TAXATION

- ***Transition Tax***
  - Imposed on accumulated foreign earnings upon transition to new participation exemption system
  - A portion of the mandatory income inclusion is deductible
  - No foreign tax credit or deduction allowed for amount for which the deduction is allowed
  - Net tax liability can be paid in 8 installments

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IMPACT ON INTERNATIONAL TAXATION

- ***Base Erosion***
  - Taxation on ECI and FDAP Income
  - Reporting Requirements
  - Calculation of Base Erosion Tax Payments

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IMPACT ON INTERNATIONAL TAXATION

- ***Interest Limitation***
  - Allocation and apportionment of interest expense to foreign-source income
  - Must be made on the basis of the assets, not gross income
  - Taxpayers can no longer use fair market value method

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A Closer Look into the Tax Cuts and Jobs Act

IMPACT ON QUALIFIED RETIREMENT PLANS

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IMPACT ON QUALIFIED RETIREMENT PLANS

- ***Individual Retirement Arrangements (IRAs)***
  - IRAs are distinguished between two types – traditional and Roth
    - The primary difference between the two types of IRAs is the timing of income tax inclusion
    - Contributions to both traditional IRAs and Roth IRAs must be segregated into separate IRAs, meaning separate arrangements, trusts, accounts or contracts…and with separate documents

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IMPACT ON QUALIFIED RETIREMENT PLANS

- ***Individual Retirement Arrangements (IRAs)***
  - The prior law allows for a “recharacterization” of a contribution from one type of IRA to the other
  - If the election to recharacterize is made, the contribution is treated as if it had originally been contributed to the second IRA on the same date, and for the same tax year, as the contribution was made to the first IRA

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IMPACT ON QUALIFIED RETIREMENT PLANS

- ***Individual Retirement Arrangements (IRAs)***
  - The TCJA changes recharacterization (changing contribution from one type to the other) provisions for tax years beginning after 2017
  - Contributions to a traditional IRA that were previously converted to a Roth IRA can no longer be unwound under the legislation
  - Other recharacterizations are still allowed under the TCJA

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IMPACT ON QUALIFIED RETIREMENT PLANS

- ***IRC Section 401(k) Plans***
  - No modification to prior rules despite initial discussions to do so
- ***Non-Cash Compensation***
  - The TCJA adds a deferral opportunity for inclusion of income from qualified stock or RSUs received under Sec. 83(b) election
- ***Nonqualified Deferred Compensation***
  - No changes to rules under the TCJA

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A Closer Look into the Tax Cuts and Jobs Act

IMPACT ON EXEMPT ORGANIZATIONS

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IMPACT ON EXEMPT ORGANIZATIONS

- ***Taxation on Exempt Organization's UBTI***
  - The TCJA limits exempt organizations' use of NOLs sustained for tax years beginning after December 31, 2017
  - NOLs sustained before the enactment of the TCJA can still be carried forward to future tax period to offset income

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Tax Reform or Tax Calamity?

IMPACT ON EXEMPT ORGANIZATIONS

- ***Taxation of NII of Private Colleges and Universities***
  - New IRC section imposes 1.4% tax on net investment income of certain educational institutions for tax years beginning after December 31, 2017
- ***Excise Tax on Excessive Compensation of Executives***
  - New 21% excise tax on compensation exceeding threshold amount; likely to impact only the largest exempt organizations

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A Closer Look into the Tax Cuts and Jobs Act

CONCLUSION AND PRACTICAL CONSIDERATIONS

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CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***Many nuances and unknowns remain in the new statutes***
  - IRS Rulings, Revenue Procedures, Notices and News Releases expected and have already started
  - Up to 20 sets of Treasury Regulations expected, Section 199A coming first
  - "Technical Corrections Bill" – 6 to 12 months after passage

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Tax Reform or Tax Calamity?

CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***Actions Required of Taxpayers***
  - Waiting for clarification or doing nothing is not an option
  - Almost all provisions of the TCJA are currently in effect
  - A failure to act is to fail to realize the potential savings associated with the legislation

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CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***Individuals should consider:***
  - Expansion of standard deduction, loss of personal and dependent exemptions
  - Ramifications of losing state and local income tax deduction, miscellaneous deductions, home office deductions
  - Assessing charitable giving strategies

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Tax Reform or Tax Calamity?

CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***Businesses should consider:***
  - Asset capitalization and expensing opportunities for capital asset purchases
  - Determining/utilizing net operating losses
  - New interest deduction limitation rules and its impact on both tax and overall weighted average cost of capital

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Tax Reform or Tax Calamity?

CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***Businesses should consider:***
  - *For pass-through businesses, determination of QBI deduction
    - Structure modifications resulting from rate decreases and advantageous qualified business income "pass-through business" deduction

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CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***Planning and making the most of the tax benefits afforded by the new legislation will require diligence by both taxpayers and their advisors***

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CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***To that end, please feel free to contact Bob Grossman, Don Johnston or your Grossman Yanak & Ford LLP Tax Executive to address your specific questions relative to the facts and circumstances affecting any particular tax situation***

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Tax Reform or Tax Calamity?

CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***In the interim, GYF will continue to monitor the new law and all upcoming Congressional and Treasury releases to ensure that our clients are kept abreast of current developments and are positioned to pay the absolute minimum amount of tax required under law***

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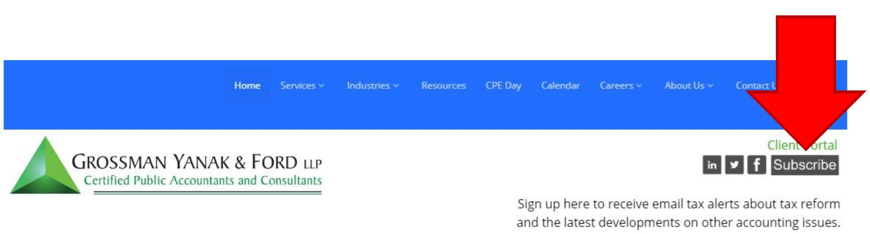
Tax Reform or Tax Calamity?

CONCLUSION AND PRACTICAL CONSIDERATIONS

- ***Please go to our website to subscribe to receive timely updates about tax reform legislation and other issues***



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FINAL QUESTIONS?

THANK YOU!