HIGHLIGHTS OF THE TAX CUTS & JOBS ACT

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act (the "Act). The following are highlights of this new law. In the near future, RRBB will issue a more comprehensive summary of the individual, business, and international provisions of this Act.

Individual Provisions:

Tax Brackets. The top bracket is now 37% (down from 39.6%) and takes effect at $500,000 for single individuals and $600,000 for married taxpayers filing jointly.

- Here's how much income would apply to the new rates:
  10% (income up to $9,525 for individuals; up to $19,050 for married couples filing jointly)
  12% (over $9,525 to $38,700; over $19,050 to $77,400 for couples)
  22% (over $38,700 to $82,500; over $77,400 to $165,000 for couples)
  24% (over $82,500 to $157,500; over $165,000 to $315,000 for couples)
  32% (over $157,500 to $200,000; over $315,000 to $400,000 for couples)
  35% (over $200,000 to $500,000; over $400,000 to $600,000 for couples)
  37% (over $500,000; over $600,000 for couples)
- Estates and trusts are subject to only four rates, with the top rate of 37% taking effect at $12,500.
- Children under the age of 19 (or who are full-time students under the age of 24) are generally still subject to the "kiddie tax;" however, this is no longer tied to the income of either parents or siblings. Unearned income of children will now be subject to tax at the same rates as trusts and estates.
- Capital gains and qualified dividends will still be eligible for preferential treatment and subject to rates of 0%, 15% and 20%. Unrecaptured section 1250 gain will continue to be taxed at 25%, while gain on the sale of collectibles will remain at 28%.
- These rates are permanent except for the kiddie tax provision which does not apply to taxable years beginning after December 31, 2025.

Personal Exemptions and Standard Deduction. Personal exemptions have been "suspended" until taxable years beginning after December 31, 2025. The standard deduction has been "temporarily" increased to $12,000 for individual filers and $24,000 for married taxpayers filing jointly. The increased amount of the standard deduction expires for taxable years beginning after December 31, 2025.

Individual Alternative Minimum Tax ("AMT"). For taxable years beginning after December 31, 2017 and before January 1, 2026, the AMT exemption is increased to $109,400 for married taxpayers filing jointly or half that amount for married individuals filing separately and $70,300 for all others (other than estates and trusts). The phase-out thresholds are increased to $1,000,000 for married individuals filing jointly and $500,000 for all other taxpayers.

Child Tax Credits. The child tax credit has been increased from $1,000 to $2,000 per qualifying child. Only $1,400 per child is refundable. Children age 17 and older are not eligible. A $500 non-refundable credit is available for other dependents. These credits phase out beginning with adjusted gross income of $400,000 for married taxpayers filing jointly and $200,000 for all others. This provision expires for taxable years beginning after December 31, 2025.

Earned Income Credit, Lifetime Learning Credit, American Opportunity Credit, Deduction for Qualified Tuition and Related Expenses. No changes have been made to existing law.

Education Related Provisions. Parents can use up to $10,000 per year from a Section 529 college savings plan towards tuition and qualified expenses for public, private, or religious elementary and secondary schools. The exclusion from income of student loan discharges and cancellation have been expanded for certain classes of debt (does not apply to discharges of debt after December 31, 2025).

Deduction for Taxes Not Paid or Accrued in a Trade or Business. Subject to the exception below, in the case of an individual, state, local and foreign property taxes and local sales taxes are deductible only when paid or accrued in carrying on a trade or business or in connection with an activity for the production of income (i.e., deductible in computing income on Form 1040 Schedules C, E or F). An individual can deduct such property taxes if they are imposed on business assets, such as residential rental property. Similarly, in the case of an individual, state and local income taxes are not deductible, subject to the exception.

The deductions for state and local property taxes (*not paid or accrued in carrying on a trade or business or in connection with an activity for the production of income*) and state and local income taxes (or sales taxes in lieu of income taxes) have been combined into a single deduction and limited to $10,000 in the aggregate ($5,000 for a married taxpayer filing separately). Foreign real property taxes are not deductible under this exception. These rules apply to taxable years beginning after December 31, 2017 and before January 1, 2026.

Home Mortgage Interest. The deductibility of interest on current mortgages of up to $1,000,000 ($500,000 in the case of married taxpayers filing separately) of principal indebtedness remains. However, in general, for new mortgages entered into between December 15, 2017 and December 31, 2025, this limit is reduced to $750,000 ($375,000 for married taxpayers filing separately). For taxable years beginning after December 31, 2025, the limit reverts to $1,000,000 ($500,000 for married taxpayers filing separately), regardless of when the indebtedness was incurred. The deduction for home equity interest is suspended, effective for taxable years beginning after December 31, 2017 and before January 1, 2026.

Charitable Contributions. The income-based percentage limit for certain charitable contributions by an individual taxpayer of cash to public charities and certain organizations is increased from 50% to 60% of adjusted gross income, effective for charitable contributions made in taxable years beginning after December 31, 2017 and before January 1, 2026.

Medical Expenses. There is a temporary reduction in the medical expense deduction floor to include costs that exceed 7.5% of adjusted gross income (rather than the 10% under current law). This applies for taxable years beginning after December 31, 2016 and before January 1, 2019.

Alimony Payments. The deduction for alimony is repealed (as well as the inclusion in income of alimony received). This provision is effective for any divorce or separation instrument executed after December 31, 2018, subject to rules governing modifications.

Moving Expenses. Subject to a limited exception, this deduction is suspended, effective for taxable years beginning after December 31, 2017 and before January 1, 2026. The exclusion from gross income and wages for qualified moving expense reimbursement (except for certain Armed Forces-related moving expenses and reimbursement) is also suspended, for taxable years beginning after December 31, 2017 and before January 1, 2026.

Personal Casualty and Theft Losses. Effective for losses in taxable years beginning after December 31, 2017 and before January 1, 2026, this deduction is repealed except for losses incurred as a result of certain federally declared disasters. Also, special relief rules apply with respect to 2016 major disasters, as to personal casualty losses and the use of retirement funds.

Miscellaneous Itemized Deductions Subject to 2% Floor. All miscellaneous itemized deductions subject to the 2% floor under current law are repealed, for taxable years beginning after December 31, 2017 and before January 1, 2026.

Limitation on Itemized Deduction (3% Limitation). The 3% limitation is repealed, for taxable years beginning after December 31, 2017 and before January 1, 2026.

Affordable Care Act Individual Shared Responsibility Payment. Under the terms of the Affordable Care Act, individuals must be covered by a health plan that provides at least a specified minimum coverage or be subject to a tax (penalty) for failure to maintain the coverage (often referred to as the “individual mandate”), subject to certain exemptions. The requirement for this payment is eliminated, i.e., would reduce the amount of the shared responsibility payment to zero. This applies to health care coverage status for months beginning after December 31, 2018.

Estate and Gift Tax Exemption. The estate and gift tax exemption is doubled, accomplished by increasing the basic exclusion amount from $5 to $10 million. The $10 million exclusion amount is indexed for inflation after 2011 ($10.98 million for 2017). The proposal is effective for decedents dying, generation skipping transfers and gifts made after December 31, 2017. The increase in the basic exclusion amount expires for decedents dying and gifts made after December 31, 2025.

Business Provisions:

Corporate Tax Rate Reduction. For taxable years beginning after December 2017, the corporate tax rate is a flat 21%. The 21% tax rate also applies to personal service corporations. It appears that the rate will be pro-rated for fiscal year filers if the taxable year includes January 1, 2018.

Dividend Received Deductions. The 80% dividends received deduction has been reduced to 65% and the 70% dividends received deduction to 50%.

Corporate Alternative Minimum Tax. The corporate AMT is eliminated. Taxpayers that have AMT credit carryforwards will be able to use them against their regular tax liability and will also be able to claim a refundable credit equal to 50% of the remaining AMT credit carryforward in years beginning in 2018 through 2020 and 100% for years beginning in 2021.

Business Income of Individuals, Trusts and Estates. The Act generally allows a non-corporate taxpayer (including a trust or estate) who has qualified business income (“QBI”) from a partnership, S corporation or sole proprietorship (pass-through entities) to deduct the lesser of:

- The combined QBI amount of the taxpayer; or
- 20% of the excess, if any, of the taxpayer’s taxable income for the tax year, less net capital gain.

QBI is defined as all domestic (U.S.- source, including Puerto Rico) business income other than investment income. QBI does not include any amount that is treated as reasonable compensation of the taxpayer for services rendered to the business (W-2 salary for S corporation) or any amount paid by a partnership that is a guaranteed payment for services performed. The 20% deduction is not allowed in computing adjusted gross income, but rather is allowed as a deduction reducing taxable income.

Limitations

For pass-through entities, the deduction cannot exceed the greater of:

- 50% of the W-2 wages attributable to QBI paid to the taxpayer; or
- The sum of 25% of the W-2 wages with respect to the qualified trade or business, plus 2.5% of the unadjusted basis of all qualified property.

Qualified property is generally defined as tangible, depreciable property that is held by, available for use, and used in the qualified trade or business at the close of the taxable year.

For a partnership or S corporation, each partner or shareholder is treated as having W-2 wages for the taxable year in an amount equal to his or her allocable share of the entity’s W-2 wages for the tax year.

The W-2 wage limit does not apply in the case of a taxpayer with taxable income not exceeding $315,000 for married individuals filing jointly ($157,500 for other individuals). This limitation is phased-in for individuals with taxable income exceeding these thresholds over the next $100,000 of taxable income for married taxpayers filing jointly ($50,000 for other individuals).

Thresholds and Exclusions

The deduction does not apply to "specified service businesses," which means any trade or business that involves the performance of services for any trade or business where the principal asset of such trade or business is the reputation or skill of one or more employees or owners.

The Act specifically excludes engineering and architecture services from the definition of specified service business. This exclusion does not apply for a taxpayer whose taxable income does not exceed $315,000 for married individuals filing jointly ($157,500 for other individuals). The deduction for service businesses is phased out over the next $100,000 of taxable income for joint filers ($50,000 for other individuals).

Excess Business Losses of Taxpayers Other than Corporations. The Act implements a new rule, which states that "excess business losses" of a taxpayer other than a corporation are not allowed for the taxable year but are instead carried forward and treated as part of the taxpayer's net operating loss ("NOL") carryforward in subsequent tax years. This limitation applies after the application of the passive activity loss rules. NOL carryovers generally are allowed for a taxable year up to the lesser of the carryover amount or 80% of taxable income.

An excess business loss for the taxable year is the excess of the taxpayer's aggregate deductions attributable to his/her trade and businesses over the sum of aggregate gross income or gain of the taxpayer, plus a threshold amount. The threshold amount for a taxable year is $500,000 for married taxpayers filing jointly and $250,000 for other individuals, with both amounts indexed for inflation.

Here's an example of how the excess business loss provision would work: Joe Smith leaves his job in 2017 to pursue his dream, a technology start-up. Joe is single and invests $500,000 of capital, and so does his partner Mary White, who is married. The 2018 LLC partnership tax return reports a net loss of $700,000. Each active partner shows a $350,000 loss on 2018 individual tax return Schedule E. Joe has an excess business loss of $100,000 ($350,000 minus the $250,000 threshold for single). The loss is an NOL carryforward. Mary can use the full loss in 2018 since it's less than the $500,000 married threshold. Mary's spouse has substantial income to utilize her loss and generate a 2018 tax refund.

Increased Bonus Depreciation. Businesses are generally allowed to write off (expense) a percentage of the cost of depreciable assets that are acquired and placed in service from September 28, 2017 to December 31, 2026. The write-off percentages are as follows:

9/28/17 to 12/31/22	100%
2023	80%
2024	60%
2025	40%
2026	20%

Section 179 Expensing. The "Section 179" small business expensing limitation is increased to $1,000,000, and the phase-out threshold is increased to $2,500,000, effective for property placed in service in taxable years beginning after December 31, 2017. These amounts are indexed for inflation. The definition of qualifying property is expanded to include certain improvements to real property.

Depreciation Limitation for Luxury Automobiles and Personal Use Property. For passenger automobiles placed in service after December 31, 2017 and for which bonus depreciation is not claimed, the luxury automobile depreciation limitation is increased to a maximum of $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year and $5,760 for the fourth and later years. The limitations are indexed for inflation for automobiles placed in service after 2018.

Recovery Period for Real Property. The provision eliminates the separate definitions of qualified leasehold improvement, qualified restaurant and qualified retail improvement property and provides a straight-line, 15-year recovery period for qualified improvement property and a 20-year "alternative depreciation system" ("ADS") recovery period for such property. The ADS recovery period for residential rental property is reduced from 40 to 30 years. Both of these rules are effective for property placed in service after December 31, 2017. The recovery period for nonresidential real and residential rental property remains at 39 and 27.5 years, respectively.

Computers and Peripheral Equipment Removed from Listed Property. Deductions for such property are no longer subject to the heighted substantiation requirements.

Accounting Simplification for Small Businesses. For certain businesses with not more than $25 million in average annual gross receipts (indexed for inflation), the following accounting simplifications apply:

- *Cash Method of Accounting.* C corporations and partnerships with C corporation partners will be able to use the cash method of accounting. Currently, the gross receipts limitation is $5 million.
- *Accounting for Inventories.* A business will be able to use the cash method of accounting even though it has inventory. The business will have to treat the inventory as non-incidental materials and supplies or conform to the taxpayer's financial accounting treatment of inventories.
- *Capitalization and Inclusion of Certain Expenses in Inventory Costs.* Businesses will be fully exempt from the UNICAP rules for real and personal property, acquired or manufactured.
- *Long-Term Contract Accounting.* Businesses that meet the threshold will be able to use a non-percentage of completion method including the completed contract method.

Accounting Methods/Special Rules for Taxable Year of Inclusion. This provision revises the rules associated with the recognition of income. For taxable years beginning after December 31, 2017, it requires a taxpayer to recognize income no later than the taxable year in which such income is taken into account as income on an applicable financial statement, subject to an exception for certain long-term contract income.

Deferral Method for Advanced Receipts. This codifies the current deferral method of accounting for advance receipts for goods and services under an IRS revenue procedure; i.e., taxpayers will be allowed to defer the inclusion of income associated with certain advance receipts to the end of the taxable year following the tax year of receipt if such income also is deferred for financial statement purposes.

Interest Expense Deduction. For taxable years beginning after December 31, 2017, the deduction for business interest is limited to the sum of business interest income, floor plan financing interest, and 30% of the "adjusted taxable income" of the taxpayer for the taxable year. The adjusted taxable income is the taxable income of the taxpayer computed without regard to (i) any item of income, gain, deduction or loss which is not properly allocable to a trade or business; (ii) any business interest or business interest income; (iii) the 20% deduction for certain pass-through income; (iv) for taxable years beginning after December 31, 2017 and before January 1, 2022 -- depreciation, amortization, or depletion; and (iv) the amount of any net operating loss deduction. The amount of disallowed interest is carried forward indefinitely. Exempt from these are businesses with average gross receipts of $25 million or less, regulated public utility companies, electing real property trade or businesses, and electing farming businesses.

Net Operating Loss Deduction. The NOL deduction is limited to 80% of taxable income (determined without regard to the NOL deduction), effective for losses arising in taxable years beginning after December 31, 2017.

Carryovers to other years are adjusted to take account of this limitation and can be carried forward indefinitely. The two-year carryback and certain special carryback provisions are repealed except for certain farming businesses and property and casualty insurance businesses. The provisions to limit carrybacks and allow indefinite carryforwards applies to losses arising in taxable years beginning after December 31, 2017.

Like-Kind Exchanges of Real Property. The like-kind exchange rules are only available for real property not held primarily for sale. The rule is for transfers after 2017 but a transition rule applies to any exchange if either the property being exchanged or received is exchanged or received on or before December 31, 2017.

S Corporation Conversions to C Corporations. In the case of an S corporation which revokes its S corporation election during the two-year period beginning on the enactment date (of this legislation) and has the same owners on both the enactment date and the revocation date, distributions from the terminated S corporation are treated as paid from its accumulated adjustments account and from its earnings and profits. Adjustments attributable to the conversion from S corporation status to a C corporation (IRC Sec. 481(a)) are taken into account ratably over six years.

Repeal of Certain Business Expenses. The following business deductions are **repealed**:

- The IRC Sec. 199 domestic production activity deduction ("DPAD") for taxable years beginning after December 31, 2017.
- The deduction for entertainment expenses other than business meals. Taxpayers will still generally deduct 50% of the food and beverage expenses associated with operating their trade or business. For amounts incurred and paid after December 31, 2017, and until December 31, 2025, the 50% limitation applies to expenses of the employer associated with meals provided for the convenience of the employer on the employer's business premises, or provided on or near the employer's business premises through an employer-operated facility that meets certain requirements: such amounts paid or incurred after December 31, 2025 are not deductible.
- The deduction for FDIC premiums would only be allowed for institutions with consolidated assets not exceeding $10 billion.

"Technical Termination" of Partnerships. The technical termination rule is repealed, effective for taxable years beginning after 2017. Accordingly, a partnership is treated as continuing even if more than 50% of the total capital and profit interests of the partnership are sold or exchanged, and new elections are not required or permitted.

Carried Interest. Applicable to tax years beginning after December 31, 2017, and subject to certain qualifications and exceptions, transfers of "applicable partnership interests" held for three years or less are treated as short-term capital gain. An applicable partnership interest is an interest in a partnership which, directly or indirectly, is transferred to (or is held by) the taxpayer in connection with the performance of substantial services by the taxpayer or any other related person in any "applicable trade or business." An applicable trade or business is any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists in whole or in part of raising or returning capital and either (i) investing in or disposing of specified assets (or identifying such assets for investing or disposition) or (ii) developing specified assets.

Research and Development Credit. As indicated in Policy Highlights published by the Conference Committee**, the credit is preserved**.

Rehabilitation Credit. A 20% credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure, claimed ratably over a five-year period beginning in the taxable year in which a qualified rehabilitated structure is placed in service.

Employer Credit for Paid Family and Medical Leave. This provision allows eligible employers to claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave, if the rate of payment under the program is 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%. This is generally effective for wages paid in taxable years beginning after December 31, 2017; it does not apply to wages paid in taxable years beginning after December 31, 2019.

Modification of Limitation on Excessive Employee Compensation. Applicable to taxable years beginning after December 31, 2017, the exception to the $1 million deduction limitation for commissions and performance-based compensation in the case of publicly held corporations is repealed. The definition of covered employee is amended to include the principal executive officer, the principal financial officer and the three other highest paid employees. Once an employee qualifies as a covered employee, his/her compensation is subject to the $1 million limitation as long as the executive (or beneficiary) receives compensation from the company. There is a transition rule for written binding contracts in effect as of November 2, 2017 not modified thereafter in any material respect.

Excise Tax on Excess Tax-Exempt Organization Executive Compensation. A 21% excise tax is imposed on compensation in excess of $1 million paid to a tax-exempt organization's five highest paid executives. It applies to all remuneration paid to such executives, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash, and excluding payments to a tax-qualified retirement and amounts otherwise excludable from the executive's gross income.

International Provisions:

Participation Exemption. There is a move toward a "participation exemption" system. This regime of taxation is commonplace in Europe. A 100% deduction is provided for the foreign-source portion of dividends received by a U.S. company from a 10% or more owned foreign corporation. To benefit from this deduction, there is a one year holding period requirement. As part of the transition to a participation exemption system, a repatriation tax is required on untaxed foreign earnings and profits accumulated since 1986. There is an effective 15.5% tax on cash and cash equivalents and an 8% repatriation tax on illiquid assets. Taxpayers may elect to pay tax over a period of eight years.

Foreign Tax Credit. No foreign tax credit or deduction is allowed on any dividend for which the dividends received deduction is permitted under the participation exemption. Deemed-paid foreign tax credits under IRC Sec. 902 and IRC Sec. 960 continue to be allowed for Subpart F inclusions. Further, a new foreign tax credit basket is created for foreign branch income.

Overall Subpart F Impact. There are numerous changes regarding the Subpart F regime. The Act expands the definition of a U.S. shareholder in the CFC context. Stock attribution determining CFC status is changed to treat a U.S. corporation as constructively owning stock held by its foreign shareholder. In addition, the 30-day holding period rule for CFC ownership is eliminated. Hence, even one-day ownership will trigger CFC ownership and filing obligations.

CFC's Investment in the U.S. Under pre-Act law, in general, untaxed E&P of a CFC reinvested in the U.S. triggers a current inclusion under IRC Sec. 956. The Act does not address this provision; therefore, this provision will continue to exist. The Act repeals current taxation of previously excluded qualified investments. The Act also repeals foreign base company oil related income as subpart F income under IRC Sec. 954.