January 23, 2018

NEW TAX LAW HIGHLIGHTS

On December 22, 2017, President Donald Trump signed the Tax Cuts and Jobs Act ("the Act") into law and made significant changes to the tax code. Most changes will not take place until tax years beginning after December 31, 2017 and are set to expire on January 1, 2026. Among the significant changes were:

1. <u>Section 179 Expensing</u> - The Act increased the limit a taxpayer is allowed to expense to $1 million. The expense limit "phases out" when a taxpayer purchases $2.5 million in qualifying additions.

2. <u>Bonus Depreciation</u> - The Act allows for 100 percent expensing for qualified property. In addition, the Act eliminated the requirement that the property be "new." The expensing election applies to <u>all property</u> acquired by MACRS class life in each year.

3. <u>Farm Property</u> - Under the Act, farm machinery and equipment can now be depreciated over 5 years if the property is new. In addition, farmers can now use a faster method of depreciation for property being depreciated over 10 years or less.

4. <u>Alternative Minimum Tax</u> - The Act eliminated the alternative minimum tax (AMT) for C Corporations. While the Act did not eliminate AMT for individuals, it did reduce the number of individuals that will be affected by the tax by raising exemptions and phase-out zones.

5. <u>Like-Kind Exchanges</u> - The rule allowing a taxpayer to defer gain on the disposal of property when he or she finds a replacement property within a certain time period is modified under the Act. Under the Act, only real property will qualify.

6. <u>Pass-Through Income Deduction</u> - The Act created a new deduction that allows a taxpayer to deduct 20 percent of his or her "qualified business income" from a partnership, sole proprietorship, or S Corporation subject to limits. "Qualified business income" does not include investment income, wages, guaranteed payments from a partnership, or reasonable compensation from an S Corporation. The deduction is limited by a "W-2 wage limitation" for taxpayers with taxable income over $315,000 for joint filers, or $157,500 for all other filers. Further, the deduction for business income earned in the fields of accounting, health, law, consulting, athletics, financial services, brokerage services, and other businesses based on reputation or skill gets "phased out" once a taxpayer's taxable income reaches $315,000 for joint filers, $157,500 for all others. No deduction is allowed for these types of service businesses once taxable income reaches $415,000 for joint filers, $207,500 for all other filers.

7. <u>Tax Rates</u> - For C Corporations, the tax rate is a flat 21 percent beginning in 2018. For individuals, there are 7 tax brackets ranging from 10 percent to 37 percent. Special tax rates (0/15/20 percent) for individuals for capital gains and qualifying dividends continue to apply.

8. <u>Kiddie Tax</u> - Under old tax law, children with unearned income over a certain amount were taxed at the parents' rates. However, under the Act, unearned income would be taxed according to the tax brackets and rates of estates and trusts. Thus, unearned income will be taxed at a 35 percent tax rate when it reaches $9,150 and a 37 percent tax rate when it reaches $12,500.

9. Itemized Deductions - Several itemized deductions were modified by the Act, including home mortgage interest, property taxes, income taxes, and miscellaneous itemized deductions. Also, the phase-out of itemized deductions for "high-incomers" was eliminated.

    a. Home Mortgage Interest - Home equity loan interest is no longer deductible beginning in 2018. Further, the debt limit on which a taxpayer can deduct home mortgage interest was reduced to $750,000. However, certain mortgages incurred before December 15, 2017 are allowed the old $1 million debt limit.

    b. Taxes - A taxpayer's deduction for state and local income taxes, personal property taxes, real property taxes, etc. is capped at $10,000.

    c. Miscellaneous Itemized Deductions - The Act completely eliminated miscellaneous itemized deductions. These include investment advisory and tax preparation fees as well as unreimbursed employee expenses.

10. Standard Deduction - The Act increased the standard deduction for individuals to $24,000 for joint filers, $18,000 for head of household filers, and $12,000 for all other filers.

11. Personal Exemptions - Beginning in 2018, the Act eliminates all personal exemptions.

12. Child Tax Credit - The Act expanded the child tax credit to $2,000 per qualifying child with up to $1,400 being refundable. In addition, the credit is not "phased out" until adjusted gross income is $400,000 for joint filers or $200,000 for all other filers.

13. Entertainment Expenses - The deduction for entertainment expenses has been eliminated.

14. Net Operating Losses - The Act limits a taxpayer's deduction for a Net Operating Loss (NOL) to 80 percent of his or her taxable income, and NOLs can no longer be carried back but rather can be carried forward indefinitely. However, certain insurance companies are able to carry back NOLs 2 years and forward 20. These insurance companies are also not limited by the 80 percent rule.

15. Individual Health Insurance Mandate - The requirement that individuals obtain health insurance or pay a penalty has been eliminated beginning in 2019. However, the requirement that businesses provide their employees with health coverage remains.

16. Estate Tax - The Act doubled the estate tax exemption to $10 million for decedents dying from January 1, 2018 to December 31, 2025. As indexed for inflation, the exemption is estimated to be $11.2 million for 2018.

This is a broad and basic summary of the new law. We will continue to digest its contents and monitor related commentary to keep you informed of any other items that could impact your tax situation.

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