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Tax cuts and jobs act

BUSINESS & INDIVIDUAL TAX PROVISIONS

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Individual:
Tax Rates

OLD LAW (2017):

MFJ Bracket

$0 - $18,500	10%
$18,501 - $75,900	15%
$75,901 - $153,100	25%
$153,101 - $233,350	28%
$233,351 - $416,70	33%
$416,701 - $470,700	35%
$470,700+	39.6%

VS

NEW LAW (2018):

MFJ Bracket

$0 - $19,050	10%
$19,051 - $77,400	12%
$77,400 - $165,000	22%
$165,001 - $315,000	24%
$315,001 - $400,000	32%
$400,000 - $600,000	35%
$600,000+	37%

Tax on $1,000,000 Old Law (2017)	$341,231
Tax on $1,000,000 New Law (2018)	<u>$309,379</u>
Savings under New Law (2018)	**$ 31,852**

Tax on $600,000 Old Law (2017)	$182,830
Tax on $600,000 New Law (2018)	<u>$161,379</u>
Savings under New Law (2018)	**$ 21,451**

Incremental tax savings on each $1M is $26,000

Capital Gain and Qualified Dividend Rates remain unchanged at 20%

Business:
Tax rates

OLD LAW

Tax rates under the old law were as follows:

$0 - $50,000	15%
$50,001 - $75,000	25%
$75,001 - $100,000	34%
$100,001 - $335,000	39%
$335,001 - $10,000,000	34%
$10,000,001 – $15,000,000	35%
$15,000,001 - $18,333,333	38%
$18,333,333+	35%

VS

NEW LAW

Flat 21% rate across the board

Tax rate change example

	C Corporation **Old Law**	C Corporation **New Law**	Tax Savings New Law vs. Old Law C Corp	Flow-thru S Corp/Partnership **New Law**	New Law tax Savings For S Corp vs C Corp
Taxable Income	1,000,000	1,000,000		1,000,000	
Tax	**340,000**	**210,000**		**309,379**	
Second Level of Tax:					
Dividend	660,000	790,000			
Tax (20% + 3.8%)	157,080	188,020			
Total Tax:	**497,080**	**398,020**	**99,060**	**309,379**	**88,641**
Overall Tax Rate	50%	40%		31%	

Business:
Bonus Depreciation

OLD LAW

- Bonus depreciation deduction was allowed, equal to **50%** of the adjusted basis of qualified property
- "Used" property **<u>does not</u>** qualify
- Qualified improvement property **<u>eligible</u>**

VS

NEW LAW

- Bonus depreciation deduction is allowed, equal to **100%** of the adjusted basis of qualified property
- "Used" property **<u>now qualifies</u>**
- Qualified improvement property **<u>no longer eligible</u>**

Business:
Section 179 deduction

OLD LAW

- Able to expense $500,000 before phase-out
- Dollar-for-dollar phase out after total purchases exceed $2M (fully phased-out at $2.5M)

VS

NEW LAW

- Able to expense $1,000,000 before phase-out
- Dollar-for-dollar phase out after total purchases exceed $2.5M (fully phased-out at $3.5M)

Business:
Section 179 deduction (continued)

OLD LAW

- Qualified Improvement Property limited:
- No residential property qualified
- Commercial property qualified, but only for "qualified leasehold improvements"

VS

NEW LAW

- Qualified Improvement Property expanded:
- Certain Residential property qualifies (furniture, appliances, carpet, etc)
- Additional Commercial property qualifies (roofs, HVAC's, and fire protection and security systems)

BONUS & SECTION 179
DEPRECIATON EXAMPLE

Facts:

$2,500,000 of asset purchases

Broken down as follows:

$1,500,000 of "original use" equipment

$1,000,000 of "qualified improvement property" (leasehold improvements)

	Old Law	New Law	Difference
179	-	1,000,000	1,000,000
Bonus	1,250,000	1,500,000	250,000
Total Additional Deductions			**1,250,000**
C-Corp 21% tax savings on difference			**262,500**
Individual 37% tax savings on difference			**462,500**

Business:
Section 199 domestic production activities deduction (DPAD)

OLD LAW

- A 9% deduction on the taxpayer's "qualified production activities income".

- Limited to 50% of the W-2 wages paid by the taxpayer during the calendar year.

VS

NEW LAW

- \- Eliminated effective 2018

Business/individual: 199A Deduction (20% Pass-Thru deduction)

NEW for 2018 and forward

20% deduction against:

- Qualified Business Income (QBI)
- REIT dividends
- PTP income

VS

- QBI is defined as: net ordinary income from a domestic qualified trade or business, but excludes amounts paid by an S-Corp as reasonable compensation and any payments by a Partnership to a partner in exchange for services
- A qualified Trade or Business means any trade or business other than a "specified service trade or business"

Business/individual:
199A Deduction - Continued

OLD LAW

- "Specified Service Trades or Businesses"
- Accounting, law, health, <u>consulting</u>, brokerage services, investment management, trading or dealing in securities or commodities

VS

NEW LAW

- Engineering and architectural services (because related to construction and manufacturing) and it appears that banking, insurance, financing and leasing may also qualify for the 20% deduction

Business/individual:
199A Deduction - Continued

OLD LAW

- Deduction is limited to the greater of:
- 50% of W-2 wages paid with respect to the qualified trade or business; or
- The sum of 25% of W-2 wages paid with respect to the qualified trade or business plus 2.5% of the unadjusted basis of all qualified property
- However, no limitations apply (including the specified service trade or business limitation) if the taxpayers taxable income is $315,000 or less for MFJ ($157,500 for all others)

VS

NEW LAW

- QBI Excludes: Amounts paid by an S-Corp as reasonable compensation and any payments by a Partnership to a partner in exchange for services
- Qualified Property:

  - tangible property
  - real property
  - the depreciable period of the property has not ended before the close of the tax year
- This deduction is scheduled to expire after 12/31/25

199a deduction example

Example	**Facts**		
20% Pass-Thru Deduction	$1,000,000 of Pass-Thru income		
	$500,000 of wages		
	$2,000,000 unadjusted basis of assets		

	Non-Service DPAD 9% Individual **Old Law**	**Non-Service** Qualified Business Individual **New Law**	**Non-Service** Net Tax Savings
Income			
Wages	500,000	500,000	
Pass-Thru Income	1,000,000	1,000,000	
9% DPAD	(90,000)	N/A	
20% Pass-Thru Deduction	N/A	(200,000)	
Taxable Income	1,410,000	1,300,000	
Tax:	**503,591**	**420,379**	**83,212**
Top Tax Rate:	39.60%	37.00%	

20% Pass-Thru Deduction limited to the greater of:		
- 50% of wages	250,000	**
or		
- 25% of wages; plus	125,000	
- 2.5% of assets	50,000	
	175,000	

**If the wages, had been $300,000 instead, the 20% deduction would have been limited to $150,000 (50% of $300,000)

Business:
Cash method of accounting

OLD LAW

- Available if the average gross receipts do not exceed $5 million for the preceding 3 years ($1 million if the business has inventories)
- Most service industries are not subject to this requirement and may use cash basis regardless of gross receipts

VS

NEW LAW

- Available if the average gross receipts do not exceed $25 million for the preceding 3 years
- The $1M threshold for businesses with inventories has been eliminated
- Service industry exclusion still applies

Business:
Accounting for long-term contracts

OLD LAW

- The percentage-of-completion method is required if the average gross receipts exceed $10 million for the preceding 3 years

VS

NEW LAW

- The percentage-of-completion method is required if the average gross receipts exceed $25 million for the preceding 3 years
- This new provision applies to contracts entered into after December 31, 2017

Business:
263a capitalization

OLD LAW

- If the average gross receipts exceed $10 million for the preceding 3 years, then fully exempt from the UNICAP rules

VS

NEW LAW

- If the average gross receipts do not exceed $25 million for the preceding 3 years, then fully exempt from the UNICAP rules

Business:
Limit on interest expense deduction

OLD LAW

- Interest paid or accrued by a business is generally deductible in the computation of taxable income

VS

NEW LAW

- All businesses are subject to a limitation of a deduction for net interest expenses in excess of 30% of the business's "adjusted taxable income".
- Adjusted taxable income is a businesses taxable income computed without regard to business interest expense, business interest income, net operating losses (NOLs), depreciation, amortization, and depletion.

Business:
Limit on interest expense deduction (Continued)

OLD LAW (continued)

- No additional information

VS

NEW LAW (continued)

- Any interest amounts limited under this rule would be carried forward indefinitely.
- Businesses with average gross receipts of $25 million or less for the preceding 3 years would be exempt from these limitation rules.

Business Interest Exp Limitation Example

	C-Corp Old Law	C-Corp New Law	Net Tax Savings
Income	2,000,000	2,000,000	
Expenses:			
- Interest	(300,000)	(300,000)	
- Depreciation	(200,000)	(200,000)	
- Other	(1,100,000)	(1,100,000)	
Interest Expense Limitation	-	30,000	
Taxable Income	400,000	430,000	
Tax:	**140,000**	**90,300**	**49,700**
Top Tax Rate:	35.00%	21.00%	

Interest expense is limited to the greater of:	
- 100% of interest expense	300,000
or	
- 30% of adjusted taxable income	
- Taxable Income	400,000
- Add back interest expense	300,000
- Add back depreciation expense	200,000
- Adjusted Taxable Income	900,000
	x 30%
Interest Expense Limited to:	270,000

Individual:
Net operating losses (NOL)

OLD LAW

- Can be used to offset all current year income.
- Any excess is carried back 2 years or carried forward 20 years

VS

NEW LAW

- Current year NOL's of $500k or less MFJ ($250k for others) can be used to offset all current year income.
- Any NOL's in excess of $500k ($250k) are disallowed in the current year and carried forward indefinitely until used up (but limited to 80% of taxable income going forward). No carryback is allowed except in limited circumstances

Individual NOL limitation example

	Old Law	New Law
Year 1		
Wages	300,000	300,000
Interest / Dividends	75,000	75,000
Capital gains	200,000	200,000
Trade/Business Income	1,000,000	1,000,000
Trade/Business NOL Limitation	N/A	-
Taxable Income	1,575,000	1,575,000
Year 2		
Wages	300,000	300,000
Interest / Dividends	75,000	75,000
Capital gains	250,000	250,000
Trade/Business Income	(1,000,000)	(1,000,000)
Trade/Business NOL Limitation	N/A	500,000
Taxable Income	(375,000)	125,000
Year 3		
Wages	200,000	200,000
Interest / Dividends	75,000	75,000
Capital gains	25,000	25,000
Trade/Business Income	200,000	200,000
NOL Carryover	(375,000)	(500,000)
Trade/Business NOL Limitation	N/A	100,000
Taxable Income	125,000	100,000

Business:
Net operating loss (NOL) deduction

OLD LAW

- Current year NOL can be used to offset all current year income.
- Any excess is carried back 2 years or carried forward 20 years

VS

NEW LAW

- Same as old law
- Any excess is carried forward indefinitely until used up (but limited to 80% of taxable income going forward). No carryback is allowed

Business:
Meals & entertainment expenses

OLD LAW

- 50% of meals and entertainment expenses are deductible

VS

NEW LAW

- 50% of meals expenses are deductible
- 0% of entertainment expenses are deductible (business or personal)

Business:
Like kind exchange (1031 exchange)

OLD LAW

- OLD LAW

- Provides deferral of gain on disposition of qualifying assets

- Applies to real estate and other qualifying types of property (e.g., vehicles, equipment, etc)

VS

NEW LAW

- NEW LAW

-Same as old law, except it applies to real estate only

Individual:
Alternative minimum tax (AMT)

OLD LAW

- AMT Exemption Amount: $86,200
- Biggest cause of AMT: State Income Tax Deduction

VS

NEW LAW

- AMT Exemption Amount: $109,400
- Since State Income Tax Deduction essentially eliminated unlikely to be in AMT now

AMT Credit Carryover Treatment:

Taxpayer can claim a refund of 50% of the remaining credits (to the extent the credits do not exceed regular tax for the year) in tax years beginning in 2019 through 2021, with any remainder claimed in 2022z

AMT Example

Example of AMT vs Regular tax

	Same Taxpayor - Same Tax Year		
Description	Regular Tax	AMT Tax	
Taxable Income	1,000,000	1,000,000	
Personal Exemptions			Phased out due to income levels
SALT deductions	(150,000)	not allowed	Mainly State income tax and real estate tax
Misc Itemized	(1,000)	not allowed	Amount over 2% of AGI
Taxable income	849,000	1,000,000	
Tax	200,000	242,000	

Tax due with the tax return is the higher of the two. So in this case AMT is higher.

Business:
Corporate alternative minimum tax

OLD LAW

- 20% AMT tax rate
- It was fairly rare for a C-Corp to be subject to AMT

VS

NEW LAW

- Eliminated for tax years after 2017

For tax years beginning after 2017, the AMT credit is refundable and can offset regular tax liability in an amount equal to 50% (100% for tax years beginning in 2021) of the excess of the minimum tax credit for the tax year over the amount of the credit allowable for the year against regular tax liability.

Individual:
Itemized deductions – mortgage interest

Mortgage Interest – OLD LAW

- \- Qualified Residence Interest on up to $1,000,000 of acquisition indebtedness and $100,000 of home equity indebtedness

VS

Mortgage Interest – NEW LAW

- \- Qualified Residence Interest on up to $750,000 of acquisition indebtedness only

<u>Mortgages Taken Out before 12/15/17 (Grandfathered):</u>

-The limit for acquisition indebtedness will remain at $1M

-If these mortgages are refinanced, the $1M limit will still remain, provided the indebtedness from the refi does NOT exceed the indebtedness amount immediately prior to being refinanced

Individual:
Itemized deductions – SALT

State & Local Tax Deduction – OLD LAW

- Able to deduct amounts paid at the state and local level, including real and personal property taxes, and income taxes

VS

State & Local Tax Deduction – NEW LAW

- Same as old law, EXCEPT, the maximum amount that can be deducted each year is $10,000 from all sources combined

2018 & Forward Consideration:

- Contribute to the CA College Access Tax Credit (in lieu of other donations) – but you must apply to be able to contribute
-You receive a Federal charitable donation for the amount; and
- A CA tax credit equal to 50% of the amount

State and local tax (Salt) deduction example

Example
SALT Deduction (State Income Tax, Real Estate Tax, & DMV Fees)

	Subject to AMT Individual	Not Subject to AMT Individual
Income		
Qualified Dividend & Cap Gain Income (20% Rate)	1,000,000	-
Ordinary Income (up to 39.6% rate)	250,000	1,250,000
Taxable Income	1,250,000	1,250,000
With SALT Deductions in full of $150,000 (Old Law - 2017)		
Pay the higher of:		
Regular Tax	-	407,488
AMT	252,500	-
Tax Liability:	**252,500**	**407,488**
With SALT Deductions limited to $10,000 (New Law - 2018)		
Pay the higher of:		
Regular Tax	257,707	448,675
AMT	-	-
Tax Liability:	**257,707**	**448,675**
Tax Increase due to SALT limitation (New Law)	5,207	41,187

CA COLLEGE ACCESS CREDIT EXAMPLE

Example	**Facts**	
CA College Access Credit	Filing: MFJ	$50,000 of Contribution to the CA College Access Credit
Contribution	$1,000,000 of Income	39.6% (Old Law) / 37% (New Law) Federal Tax Rate
	$130,000 of State Taxes Paid	13% CA Tax Rate
	$10,000 of Real Estate Taxes Paid	Assume not in AMT under Old Law

	W/O CA Donation Individual **Old Law**	W/O CA Donation Individual **New Law**	Additional Net Tax	With CA Donation Individual New Law	Net Tax Savings
Federal Calculation:					
Income	1,000,000	1,000,000		1,000,000	
I/D: State & Local Taxes Paid	(140,000)	(10,000)		(10,000)	
I/D: Donations (CA College Access Fund)	-	-		(50,000)	
I/D: Phase-Out	20,586	-		-	
Federal Taxable Income	880,586	990,000		940,000	
Federal Tax	348,712	366,300	(17,588)	347,800	18,500
California Calculation:					
Federal Taxable Income	880,586	990,000		940,000	
CA Adj: State Income Tax Addback	130,000	-		-	
CA Adj: CA Donation Addback	-	-		50,000	
CA Adj: CA Phase-Out	(20,586)	-		-	
CA Taxable Income	990,000	990,000		990,000	
California Tax	131,670	131,670	-	131,670	-
CA Tax Credit	-	-		(25,000)	
Net CA Tax Due	131,670	131,670	-	106,670	25,000
Total Tax Due	480,382	497,970	(17,588)	454,470	43,500

Individual:
Itemized deductions – medical expenses

Medical Expenses – OLD LAW

- Only medical expenses in excess of 10% (7.5% if age 65 or older) of AGI qualify as itemized deductions

VS

Medical Expenses – NEW LAW

- -Only medical expenses in excess of 7.5% (regardless of age) of AGI qualify as itemized deductions for 2018 and 2019
- -7.5% increases to 10% after 2019

Individual:
Itemized deductions - donations

Donations – OLD LAW

- Generally limited to 50% of a taxpayers AGI (limited to 30% or 20% in some circumstances)
- Donations providing college athletic seating rights, only 80% deductible

VS

Donations – NEW LAW

- 50% limitation increased to 60%. The other limitations were not changed.
- Donations providing college athletic seating rights, now 0% deductible

Individual:
Itemized deductions – misc. deductions

2% Misc. Deductions – OLD LAW

- Able to deduct various miscellaneous itemized deductions to the extent they exceed 2% of AGI

- This included: Investment management fees, some tax prep fees, unreimbursed employee expenses, etc.

VS

2% Misc. Deductions – NEW LAW

- These deductions have been eliminated in full

Individual:
Itemized deductions – phase-out

OLD LAW

- Limit on Itemized Deductions (Phase-Out) – OLD LAW
- \- At certain income thresholds, itemized deductions are reduced by 3% of the taxpayers AGI, not to exceed an 80% overall reduction to the itemized deductions

VS

NEW LAW

- Limit on Itemized Deductions (Phase-Out) – NEW LAW
- \- The limit/phase-out has been eliminated

Individual:
Standard deduction & personal exemptions

OLD LAW

- Standard Deductions:

  $6,500 – Single & MFS

  $9,550 – Head of Household

  $13,000 – Married Filing Joint

- Personal Exemptions:

  $4,050 per qualifying person, subject to phase-out

VS

NEW LAW

- Standard Deductions:

  $12,000 – Single & MFS

  $18,000 – Head of Household

  $24,000 – Married Filing Joint

- Personal Exemptions:

  Eliminated after 12/31/17

Individual:
529 plans

OLD LAW

- Can only be used for qualified “higher” education expenses

VS

NEW LAW

- Same as old law, BUT, can pull out up to $10,000 per year per student for elementary and high school expenses (including private school tuition)

Business:
Personal service corporation tax rate

OLD LAW

- Flat 35% tax rate

VS

NEW LAW

- Flat 21% tax rate

A PSC is a corporation the principal activity of which is the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performance arts, or consulting, and such services are substantially performed" by the employee-owners.

Individual:
Alimony deduction

OLD LAW

- Alimony and separate property payments are deductible by the payor spouse and includible in income by the recipient spouse

VS

NEW LAW

- For divorce or separation decrees finalized after **2018**, this deduction is eliminated for the payor spouse and the recipient spouse does not need to pick-up any income