TAX CUTS AND JOBS ACT

PBMares, LLP Analysis

December 20, 2017

On Friday afternoon, the combined House and Senate Conference Committee unveiled a reconciled tax bill (The Tax Cuts and Jobs Act) that would significantly overhaul individual and business tax filings. Most individual provisions will be in effect from January 1, 2018 through December 31, 2025 while most business provisions are permanent beginning January 1, 2018. Republicans, who drafted the bill, believe they have the votes needed to pass the legislation and are aiming for a vote on the proposed legislation as soon as Tuesday or Wednesday of this week. If approved by both houses, the bill will go to the President for his signature to become law.

This is a major legislation and will result in significant changes in both your individual and business filings. Proper planning remains a significant part of our year-end planning efforts over the next two weeks.

Determining the maximum state income tax deduction available in 2017 and state income tax liability to pay no later than December 31, 2017 is a top priority. Other tax planning options such as, but not limited to, charitable giving, accelerating or deferring income depending on AMT calculations, and recognizing unrealized capital losses are also on our list of items to address. Please be sure to contact your PBMares tax advisor to discuss what this bill may mean for you.

Below you'll find a summary of the proposed changes to Individual, Estate and Business Tax Law:

Individual Changes:

- New Tax Rates – We will continue to have seven brackets, but with reduced rates and a higher income level required before reaching the top bracket. The new brackets are: 10%, 12%, 22%, 24%, 32%, 35% and 37%.
- New Standard Deduction – The new standard deduction is increased to $12,000 for single filers, $18,000 for head of household filers, and $24,000 for married filing jointly.
- Personal Exemptions – There will be no more personal exemptions (previously $4,050/person).
- Alternative Minimum Tax (AMT) – No single taxpayers making under $500,000 or married filing jointly taxpayers making under $1,000,000 will be subject to AMT exemption phase-out.
- Itemized Deductions – This is where the greatest number of changes have taken place:
  - Overall Limitation Repealed – Itemized deductions will no longer phase out.
  - State and Local Tax (SALT) Deduction – This is now limited to $10,000 for all filing statuses (aside from $5,000 for married filing separately). All real estate, state and local income tax, state and local sales tax must be combined and limited to a maximum amount of $10,000.
  - Mortgage Interest – Taxpayers may now only deduct the interest on $750,000 (previously $1,000,000) of home acquisition or refinance debt. This is effective for mortgages obtained on or after December 15, 2017, with few exceptions. Additionally, the $100,000 previously allowed for home equity loans is repealed. This is the case regardless of when the home equity indebtedness was incurred.

- Charitable Contributions – Cash donations to qualifying public charities are now limited to 60% of AGI rather than 50% of AGI.
- Medical Deductions – The 10% threshold for taxpayers under 65 is reduced to 7.5% for 2017 and 2018 before reverting back. For those over 65, it remains at 7.5%.
- Casualty Losses – No longer allowed aside from those resulting from a Federally declared disaster.
- Miscellaneous Itemized Deductions Subject to 2% Limitation – These are no longer allowed and include items such as: broker fees, tax preparer fees, unreimbursed employee expenses, safe deposit boxes, employee home office deductions, etc.

- Child Tax Credit – Now $2,000 per qualifying child (increased from $1,000) with up to $1,400 being refundable (payable even if a taxpayer's liability was zero because of low income). Income phase out levels are raised to $200,000 (single) and $400,000 (married filing jointly).
- Other Dependents Credit – A credit of up to $500 per dependent who is not a qualifying child but is a dependent. This is for children 17 or older, elderly dependents, disabled older children, etc.
- Moving Expenses – These will no longer be deductible except in connection with active duty military permanent change of station.
- Alimony – This provision doesn't go into effect until January 1, 2019. For agreements signed on or after this date, alimony will no longer deductible by the payor or includable in taxable income by the payee.
- 529 Plans – May now be used for elementary and secondary education up to $10,000 per year per student.
- Individual Mandate/Penalties for Not Having Health Insurance – The individual mandate to carry health insurance and the associated penalties will no longer be in effect as of January 1, 2019.

There were several provisions that were in either the House or Senate bills that didn't make it into the final reconciled bill. As a few were widely discussed in the news, here's a quick summary of those changes you needn't worry about:

- Principal Residence Exclusion – You may still exclude $250,000 ($500,000 for married filing jointly) of gain on a principal residence as long as you've lived in it two of the last five years.
- 401(k) contributions – There will be no reduction in contribution limits.
- "Above the Line" Deductions that Remain in Place – Student Loan Interest, Educator Expenses, Qualified Tuition and Related Expenses Deduction.
- American Opportunity Credit and Lifetime Learning Credit – Remain in current form.
- Other Credits that were not altered – Credit for Elderly and Permanently Disable, Credit for Plug in Electric Drive Motor Vehicles and Adoption Credit.

Estate and Gift Tax Changes:

- Doubled Estate Tax Exemption – Now up to $10.98 million per person can pass through an estate tax-free.

Business Changes:

- Corporate Tax Rate – The graduated rate structure has been removed and replaced with a 21% corporate tax rate.
  - There will be no more Corporate AMT.
- Taxation of Business Income for Individuals, Trusts & Estates – Taxpayers may now deduct 20% of qualified business income from a partnership, S Corporation or sole proprietorship.
  - There are limitations to the deduction based on a taxable income threshold of $315,000 for married filing jointly and $157,500 for other filings statuses. If a taxpayer's taxable income exceeds this threshold:
    - The deduction may be limited based on a calculation of the entity's W-2 wages and qualified property, and
    - Specified service trade or business income may be excluded from the definition of qualified business income.
    - This provision is set to sunset after the 2025 tax year along with the individual tax changes.
- Cost Recovery Changes
  - Bonus Depreciation increases to 100% for assets purchased and placed in service after September 27, 2017 through 2022 and will then reduce by 20% per year until it is eliminated in 2027.
    - Both new and used property now qualify for bonus depreciation.
    - There are special provisions for property acquired before September 28, 2017 but placed in service that day or after.
  - Passenger Automobiles Depreciation – Deductions increase to $10,000 the first year, $16,000 the second, $9,600 the third, and $5,760 in following years.
  - Effective January 1, 2018, Section 179 Depreciation will now be allowed on purchases up to $1,000,000 and phase outs will not begin until assets placed in service for the year exceed $2,500,000.
    - Some improvements to nonresidential real property now qualify for Section 179.

- Business Related Expenses and Deductions
  - Business interest for taxpayers with average annual gross receipts over $25 million will be limited to various income items.
  - Net Operating Losses (NOLs) can now be carried forward indefinitely, but the two-year carryback provision was repealed. NOLs can only be used to offset 80% of taxable income.
  - Like Kind Exchanges are now limited to real property not primarily held for sale.
  - The Domestic Production Activities Deduction has been repealed.
  - No deduction will be allowed for entertainment. Meals, even those furnished for the convenience of the employer, will be deductible at 50%.

Small Business Accounting Methods

- Businesses with average annual gross receipts of $25 million or less over the prior three years are now eligible for the cash method of accounting. This amount will be indexed for inflation after 2018. Taxpayers meeting this threshold are also:
  - No longer subject to the Section 263A UNICAP rules, and
  - Now allowed to use the completed contract method of accounting versus percentage of completion.
- There is a New Credit for Paid Family and Medical Leave – Employers can claim a credit of between 12.5% and 25% of wages paid to qualifying employees as long as they pay between 50% and 100% of normal wages to an employee on family or medical leave.

Some Tax Planning Opportunities:

- State Taxes Paid – This is the last year you can deduct all of your state and local income taxes. Though deductions will be limited to those taxes attributable to 2017 tax liabilities we want to be sure you are fully paid in for 2017, as that missed deduction would be permanent.
- Charitable Contributions – If you will not itemize deductions in 2018, consider accelerating a contribution into 2017. However, if you have a high AGI and plan on making a substantial contribution, it may be best to wait until 2018 because there will be no phase-out of itemized deductions.

There are many more changes and this list is not exhaustive. But what can be exhausting is trying to figure out your year-end tax strategy without a financial professional by your side. Stay with PBMares as we help you, and your business, navigate through tax changes.

Disclaimer: These tax planning strategies are based on the tax bill passed by Congress on Wednesday, December 20. Topics are subject to change. This list in no way fully encompasses all proposed tax changes. Always ensure you are reviewing the latest information available. Contact your tax advisor for further clarification.

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