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Tax Bill Signed Into Law

By Christopher M. Armstrong

On December 22, 2017, President Donald J. Trump signed into law H.R. 1, a bill that represents the most significant change to the Internal Revenue Code in more than 30 years. Unless otherwise noted herein, the provisions of the new law relating to individuals, trusts and estates are applicable only for tax years beginning on January 1, 2018, through December 31, 2025, after which they will expire. The corporate and business changes are permanent. Below is a summary of some of the tax law's major provisions. There are many other provisions and changes that are too numerous to list.

Individuals

Individual Tax Rates

Individuals, based on filing status, are subject to seven tax rates:

Prior Law: 10%, 15%, 25%, 28%, 33%, 35% and 39.6%
New Law: 10%, 12%, 22%, 24%, 32%, 35% and 37%

Standard Deduction

Prior Law: Inflation-adjusted standard deduction amounts:

- $12,700 for married individuals filing jointly.
- $9,350 for heads of household.
- $6,350 for single individuals and for married individuals filing separately.

New Law: The 2018 standard deduction amounts:

- $24,000 for married individuals filing jointly.
- $18,000 for heads of household.
- $12,000 for single individuals and for married individuals filing separately.

Personal Exemptions

Prior Law: Exemptions were allowed for the taxpayer, the taxpayer's spouse, and any dependents. For 2017, the amount deductible for each personal exemption was $4,050, subject to a phase-out for taxpayers with higher incomes.

New Law: Personal exemptions are repealed.

Alternative Minimum Tax ("AMT")

The alternative minimum tax is an income tax, separate and apart from the regular income tax, and is intended to prevent high-income taxpayers from avoiding tax liability through the use of various exclusions, deductions and credits. Under this system, AMT rates are applied to AMT income, which is determined after the taxpayer adds back certain specified tax benefits. If the tax determined under the AMT calculation exceeds the regular tax, the larger amount is owed. In computing AMT, only alternative minimum taxable income in excess of the AMT exemption amount is taken into account.

Prior Law: AMT exemption amounts for 2017:

- $84,500 for married individuals filing jointly.
- $42,250 for married individuals filing separately.
- $54,300 for single taxpayers.
- $24,100 for estates and trusts.

Additionally, the AMT exemption amounts were gradually phased out starting at:

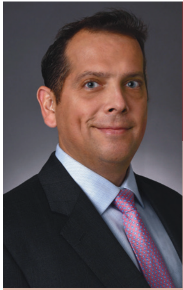
- $160,900 for married individuals filing jointly (phase-out complete at $498,900).
- $80,450 for married individuals filing separately and estates and trusts (phase-out complete at $249,450).
- $120,700 for single taxpayers (phase-out complete at $337,900).

New Law:
Exemption amounts:

- $109,400 for married individuals filing jointly.
- $54,700 for married individuals filing separately.
- $70,300 for single taxpayers.
- $24,600 for estates and trusts.

Phase-out amounts are increased:

- $1,000,000 (up from $160,900) for married individuals filing jointly.
- $500,000 (up from $120,700) for all other individual filers.
- $82,050 (up from $80,450) for estates and trusts.



who's who

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Mortgage and Home Equity Loan Deduction Limitation

Prior Law: Under prior law, taxpayers could deduct (as an itemized deduction) qualified residence interest, which included interest paid on a mortgage secured by a principal residence or a second residence. The underlying mortgage loans could represent acquisition indebtedness of up to $1,000,000, plus home equity indebtedness of up to $100,000.

New Law: The deduction for mortgage interest is limited to acquisition indebtedness of up to $750,000 ($375,000 for married individuals filing separately). The deduction for interest on home equity indebtedness is suspended.

Note: The new law *does not apply* to taxpayers who refinance existing qualified residence indebtedness that was incurred before December 15, 2017, so long as the resulting indebtedness is not greater than the refinanced indebtedness.

State and Local Tax Deduction Limitation

Prior Law: Taxpayers could deduct (as an itemized deduction) several types of taxes paid at the state and local level, including real and personal property taxes, income taxes and sales taxes.

New Law: Subject to the exception described below, (1) state and local property taxes and (2) state and local income taxes (or sales taxes in lieu thereof) are deductible only when paid or accrued in (1) carrying on a trade or business or (2) an activity described in Section 212 of the Internal Revenue Code (i.e., an activity engaged in for the production of income).

The exception to the new law relating to state and local taxes provides that a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for married individuals filing separately) for the aggregate of (1) state and local property taxes and (2) state and local income taxes (or sales taxes in lieu thereof) paid or accrued in the tax year.

Estate and Gift Tax

Prior Law: For the estates of decedents dying and gifts made in 2017, the "basic exclusion amount" was $5,490,000, as indexed for inflation.

New Law: In 2018, the basic exclusion amount will be approximately $11,200,000 per person, as indexed for inflation. For taxable estates, the tax rate will be 40%.

The estate and gift tax was not repealed and will revert to prior levels in 2026.

Corporate and Business

Corporate Tax Rate

Prior Law:

- Personal service corporations paid tax on their entire taxable income at the rate of 35%.
- Corporations were subject to graduated tax rates:
  - 15% for taxable income of $0-$50,000.
  - 25% for taxable income of $50,001-$75,000.
  - 34% for taxable income of $75,001-$10,000,000.
  - 35% for taxable income over $10,000,000.

New Law:

- Personal service corporations have no special rate.
- Corporations are subject to a flat 21% tax rate.

Corporate Alternative Minimum Tax

Prior Law: The corporate AMT was 20%, with an exemption amount of up to $40,000.

New Law: The corporate AMT is repealed.

Dividends Received Deduction

Corporations that receive dividends from other corporations are entitled to a deduction for dividends received.

Prior Law: If the corporation owned at least 20% of the stock of another corporation, an 80% dividends received deduction was allowed. Otherwise, a 70% deduction was allowed.

New Law: If the corporation owns at least 20% of the stock of another corporation, a 65% dividends received deduction is allowed. Otherwise, a 50% deduction is allowed.

Net Operating Loss ("NOL")

A net operating loss is the amount by which a taxpayer's business deductions exceed their gross income in the same tax year.

Prior Law: NOLs could not be deducted in the year generated, but could be carried forward 20 years and carried back two years.

New Law: The NOL deduction will be limited to 80% of taxable income. The deduction can be carried forward indefinitely and the two-year carry back period (except for certain losses incurred in the trade or business of farming) is repealed.

Property and casualty insurance companies may continue to use the prior law's two-year carryback and 20-year carry forward to offset 100% of taxable income.

Bonus Depreciation

Prior Law: A first-year bonus depreciation deduction was allowed equal to 50% of the adjusted basis of qualified property, the original use of which began with the taxpayer, placed in service before January 1, 2020.

New Law: A 100% first-year deduction is allowed for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023. The additional first-year depreciation deduction is allowed for new and used property, unlike the prior law which only applies to new property.

Section 179 Expensing

Subject to certain limitations, a taxpayer may elect under Section 179 of the Internal Revenue Code to expense the cost of certain qualifying property, as opposed to recovering such costs through depreciation deductions.

Prior Law: The maximum amount a taxpayer could expense was $500,000 of the cost of qualifying property placed in service for the tax year, subject to a phase-out to the extent that the cost of such qualifying property exceeded $2,000,000.

New Law: The maximum amount a taxpayer may expense is increased to $1,000,000, subject to a phase-out to the extent that the cost of such qualifying property exceeds $2,500,000.

Section 1031 Exchanges

Section 1031 of the Internal Revenue Code provided that no gain or loss was recognized to the extent that property held for productive use in a taxpayer's trade or business, or property held for investment purposes, was exchanged for property of a like-kind that also was held for productive use in a trade or business or for investment.

Prior Law: Section 1031 applied to a wide range of property from tangible personal property to real property.

New Law: Section 1031 is modified to apply only to real property. Tangible personal property such as artwork, aircraft and boats will no longer qualify for tax deferral. Under a transition rule, the prior like-kind exchange rules apply to exchanges of personal property if the taxpayer either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017.

Pass-Through Entities

Deduction for Pass-Through Income

Prior Law: The net income of pass-through entities (e.g., sole proprietorships, partnerships, limited liability companies, S corporations) was not subject to tax at the entity level and was instead reported by the owners or shareholders, as applicable, on their individual income tax returns. Therefore, the income was ordinary income.

New Law: A new section has been added to the Internal Revenue Code, Section 199A, "Qualified Business Income," under which a noncorporate taxpayer (which term includes trusts and estates), who has qualified business income from a pass-through entity is allowed a deduction of 20% subject to certain limitations and thresholds. Those in personal service businesses, such as doctors and lawyers, can only take this deduction if their taxable income is under $315,000 for married individuals filing jointly or $157,500 for all other individual taxpayers.

Repeal of Partnership Technical Termination

Prior Law: Under Section 708(b)(1)(B) of the Internal Revenue Code, a partnership was consid-

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ered terminated if, within any 12-month period, there was a sale or exchange of 50% or more of the total interest in partnership capital and profits. A technical termination resulted in a deemed contribution of all the partnership's assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to the purchasing partners and the other remaining partners. As a result of a technical termination, some of the tax attributes of the old partnership terminated, partnership-level elections generally ceased to apply, the partnership's tax year closed, and the partnership depreciation recovery periods restarted.

New Law: Section 708(b)(1)(B) is repealed.

Carried Interest

Prior Law: Generally, the receipt of a partnership interest for services provided to a partnership resulted in income to the recipient. However, under a safe harbor rule, the receipt of a partnership interest in exchange for services was not a taxable event if the partnership interest entitled the holder to share only in partnership profits generated after the date of issuance. The profits interest was often carried over from year to year until a cash payment was made, typically following the closing out of an investment, hence the term "carried interest." The owner of a carried interest was entitled to long-term capital gain treatment upon its sale, assuming that it was held for longer than one year.

New Law: A new three-year holding period requirement is imposed for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain. This rule specifically applies to businesses that engage in capital market transactions or other specified investments. Certain equity interests and interests held by corporations are exempt from this rule.

International Tax

Territorial System

Prior Law: The U.S. employed a worldwide tax system that taxed U.S. companies on all their profits, regardless of where the income was earned. However, foreign income earned by a foreign subsidiary of a U.S. corporation generally was not subject to U.S. tax until the income was distributed as a dividend to the U.S. corporation (*i.e.*, until it was repatriated).

New Law: The worldwide tax system is replaced with a territorial system that provides for an exemption for certain foreign income. The exemption is a 100% deduction for the "foreign-source portion" of dividends received by domestic corporations that are U.S. shareholders of specified 10%-owned foreign corporations. The foreign-source portion of a dividend from a specified 10%-owned foreign corporation is that amount that bears the same ratio to the dividend, as the undistributed foreign earnings of such foreign corporation bears to the total undistributed earnings of such foreign corporation.

In addition, U.S. shareholders owning at least 10% of a foreign subsidiary generally must include in income, for the subsidiary's last tax year beginning before 2018, the shareholder's pro rata share of the post-1986 historical earnings & profits ("E&P") of the foreign subsidiary to the extent such E&P has not been previously subject to U.S. tax. The portion of the E&P that is comprised of cash or cash equivalents is taxed at a rate of 15.5%, while any remaining E&P is taxed at a rate of 8%. At the election of the U.S. shareholder, the tax liability is payable over a period of up to eight years.

Conclusion

Given that certain provisions of the new tax law will expire in 2026, now is an excellent time to contact one of our Tax/Trust and Estates attorneys to more thoroughly review how the law impacts you and also the various planning opportunities available to enable you to maximize the benefits and minimize the associated burdens.

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