2017 Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act was signed by President Trump on December 22, 2017. The Act makes sweeping changes to the U.S. tax code and impacts virtually every taxpayer. For individuals, changes include a decrease in the tax rates, repeal of the personal exemption, increase in the standard deduction, and modification to itemized deductions. For businesses, tax benefits include a reduction in the corporate tax rate, an increase in the bonus depreciation allowance, an enhancement to the Code Sec. 179 expense and near total repeal of the alternative minimum tax. Owners of partnerships, S corporations, and sole proprietors are allowed a temporary deduction as a percentage of qualified income of pass-through entities, subject to many limitations and qualifications. On the other hand, numerous business tax preferences are eliminated.

Summary of Changes

Under the Tax Cuts and Jobs Act, personal exemptions are repealed ($4,050 in 2017) for 2018 through 2025. Instead, the Tax Cuts and Jobs Act provides for a near doubling of the standard deduction. For the tax year 2018, it increases the standard deduction from $12,700 to $24,000 for married individuals filing a joint return; $9,350 to $18,000 for head-of-household filers; and $6,350 to $12,000 for all other individuals. These standard deduction amounts are indexed for inflation for tax years beginning after 2018. The additional standard deduction for the elderly and the blind ($1,250 for married taxpayers, $1,550 for single taxpayers) is retained.

These are just highlights of the changes and the impact of the Tax Cuts and Jobs Act. There is much more to discuss than can be covered in this letter. We can help you with the immediate and long-term impact of the Tax Cuts and Jobs Act on your situation. Please call our office for guidance on all the provisions that directly affect you.

Itemized Deductions

Mortgage Interest Deduction. The Tax Cuts and Jobs Act limits the mortgage interest deduction to interest on $750,000 of acquisition indebtedness ($375,000 in the case of married taxpayers filing separately), for tax years beginning 2018 through 2025. For acquisition indebtedness incurred before December 15, 2017, the Tax Cuts and Jobs Act allows current homeowners to keep the current limitation of $1 million ($500,000 in the case of married taxpayers filing separately). Taxpayers may continue to include mortgage interest on second homes, but within those lower dollar caps. However, no interest deduction will be allowed for interest on home equity indebtedness.

State and Local Taxes. The Tax Cuts and Jobs Act limits the itemized tax deduction for all nonbusiness state and local taxes deductions, including property taxes, to $10,000 ($5,000 for married taxpayer filing a separate return) for 2018 through 2025. Sales taxes may be included as an alternative to claiming state and local income taxes.
Charitable Contributions. The Tax Cuts and Jobs Act increases the limitation of charitable contributions to 60% of adjusted gross income for tax years 2018 through 2025.

Miscellaneous Itemized Deductions. The Tax Cuts and Jobs Act repeals all miscellaneous itemized deductions for tax years 2018 through 2025 that are subject to the 2% floor under current law. Included in this are investment fees and unreimbursed employee business expenses.

Medical Expenses. The Tax Cuts and Jobs Act lowers the threshold for the deduction to 7.5% of adjusted gross income (AGI) for tax years 2017 and 2018.

Casualty Losses. For tax years 2018 through 2025, a casualty loss will only be allowed to the extent it is attributable to a federal declared disaster area.

The phaseout of itemized deductions is suspended for tax years 2018 through 2025. Taxpayers will not see a reduction in allowable itemized deductions no matter the income level.

The doubling of the standard deduction and modifications to itemized deductions effectively eliminates many individuals from claiming itemized deductions. For example, for most married taxpayers filing jointly, unless their allowable itemized deductions exceed $24,000, they would claim the standard deduction. Allowable deductions include mortgage interest, taxes (capped at $10,000), charity and medical expenses.

Pass-Through Businesses

Currently, up to the end of 2017, owners of partnerships, S corporations, and sole proprietorships – as “pass-through” entities – pay tax at the individual rates, with the highest rate at 39.6%. The Tax Cuts and Jobs Act allows a temporary deduction in an amount equal to 20% of qualified income of pass-through entities. Specifically limited by this change are businesses which are considered specified service businesses. These include fields of health, law, legal, consulting, management, investment, trading, and any other business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. Additionally, the deduction for certain companies is limited to W-2 wages included in qualified business income and/or 2.5% of the original cost of all properties placed in service by qualified businesses within the last ten years. All of the above is based on the percentage owned by each pass-through owner.

Bonus Depreciation

The bonus depreciation rate has fluctuated wildly over the last 15 years, from as low as 0% to as high as 100%. It is often seen to incentivize business growth and job creation. The Tax Cuts and Jobs Act temporarily increases the 50-percent bonus depreciation allowance to 100% effective September 27, 2017. It also removes the requirement that the original use of qualified property must commence with the taxpayer, thus allowing bonus depreciation of used property. For real estate, a new qualified improvement property category allows for 100% bonus depreciation.
**Section 179 Expensing**

The Tax Cuts and Jobs Act sets the Code Sec. 179 dollar limitation at $1 million and the investment limitation at $2.5 million. Although the differences between bonus depreciation and Code Sec. 179 expensing would now be narrowed if both offer 100% write-offs for new or used property, some advantages and disadvantages for each will remain. For example, Code Sec. 179 property is subject to recapture if business use of the property during a tax year falls to 50% or less, but Code Sec. 179 allows a taxpayer to elect to expense only particular qualifying assets within any asset class.

**Deductions and Credits**

Numerous business tax preferences are eliminated. These include the Code Sec. 199 domestic production activities deduction and non-real property like-kind exchanges. The Tax Cuts and Jobs Act leaves the research and development credit in place, but requires five-year amortization of research and development expenditures. It also creates a temporary credit for employers paying employees who are on family and medical leave.

**Interest Deductions**

To “level the playing field” between businesses that capitalize through equity and those that borrow, the Tax Cuts and Jobs Act generally caps the deduction for net interest expenses at 30% of adjusted taxable income, among other criteria. Exceptions exist for small businesses, including an exemption for businesses with average gross receipts of $25 million or less. Any unused interest is subject to a five-year carryforward period. There are exceptions for real estate businesses but in exchange for less advantageous depreciation.

**Alimony**

The Tax Cuts and Jobs Act repeals the alimony deduction for the payor spouse as well as the corresponding income inclusion by the receiving spouse effective for any divorce or separation decree executed after December 31, 2018 or for any decree finalized by December 31, 2017 but modified after December 31, 2018.

**Corporate Taxes**

A reduced 21-percent corporate tax rate is permanent beginning in 2018. Also, the 80-percent and 70-percent dividends received deduction under current law are reduced to 65-percent and 50-percent, respectively. The Act also repeals the alternative minimum tax on corporations.
Net Operating Losses

The Tax Cuts and Jobs Act modifies current rules for net operating losses (NOLs). Generally, NOLs will be limited to 80% of taxable income for losses arising in tax years beginning after December 31, 2017. It also denies the carryback for NOLs in most cases while providing for an indefinite carryforward, subject to the percentage limitation.

Limitation on Business Losses for Individual Taxpayers

Beginning January 1, 2018, total net business losses (other than C Corporation) cannot be applied to offset non-trade or business income (W-2 wages, portfolio interest, dividends, and capital gains) to the extent the loss exceeds $500,000 (joint) or $250,000 (single). The excess is carried over and becomes (or adds to) a net operating carryover.

Carried Interest

The Tax Cuts and Jobs Act extends the holding period for long term capital gain treatment from one year to three years for partnership interests held regarding the performance of services beginning in 2018.

Meals & Entertainment

The Tax Cuts and Jobs Act repeals the 50% deduction allowed for entertainment and membership dues for any club organized for business. The Act keeps the 50% deduction for food and beverage expenses associated with operating a trade or business.