The Tax Cuts and Jobs Act of 2017

December 22, 2017

H.R. 1, better known as The Tax Cuts and Jobs Act of 2017 (the "Act"), passed both the House and Senate earlier this week and was signed by President Trump. Most of the relevant provisions of the Act will be effective for tax years starting after December 31, 2017, and most are no longer effective for tax years starting after December 31, 2025. This Client Alert is intended to provide a high-level overview of the most noteworthy changes to the Internal Revenue Code under the Act and highlight tax planning opportunities that may exist for the remainder of 2017. The Act contains more provisions than can be summarized in this Alert. A more in-depth analysis will be forthcoming in early 2018.

CHANGES IMPACTING INDIVIDUALS

- **Lower Income Tax Rates**. The highest-marginal individual income tax rate is reduced from 39.6% to 37%. Married taxpayers filing jointly will not reach the maximum rate until their taxable income exceeds $600,000. Under current law, the maximum rate is reached when taxable income exceeds $480,050. As under current law, the Act applies seven tiers of income tax rates. The Act does not change the tax rates on long-term capital gains and qualified dividends or the 3.8% net investment income tax applicable to certain high-income taxpayers.

Planning Opportunity - Taxpayers may benefit from deferring realization of income until 2018 when the lower rates are effective, although the Act's limit on state and local tax deductions must also be considered.

- **Increase in Standard Deduction and Elimination of Personal Exemptions**. Under current law, the standard deduction is $6,350 for a single filer and $12,700 for married taxpayers filing jointly. The Act increases the standard deduction to $12,000 for a single filer and $24,000 for married taxpayers filing jointly. The personal exemption of $4,050 per person under current law is eliminated entirely under the Act.
- **Increase in Child Tax Credit**. The Child Tax Credit is increased from $1,000 per child under current law to $2,000 per child under the Act. The credit begins to phase out when income exceeds $400,000 for married taxpayers filing jointly.
- **Limit on Mortgage Interest Deduction**. Under current law, taxpayers who itemize may deduct mortgage interest on up to $1,000,000 of debt incurred to acquire a residence. The Act limits the eligible debt to $750,000, but grandfathers existing mortgages. The Act also eliminates the deduction for interest

arising from home equity loans.

- **Medical Expense Deduction**. Medical expenses in excess of 7.5% of adjusted gross income are deductible for 2017 and 2018.
- **Charitable Deductions**. Gifts to charity remain deductible under the Act. The Act increases the amount that may be deducted for cash donations to public charities from 50% to 60% of adjusted gross income.

Planning Opportunity. Because of the increase in the standard deduction and the limit on state and local tax deductions, taxpayers will be less likely to claim itemized deductions beginning in 2018. Consider accelerating charitable deductions into 2017.

- **529 Plans**. Qualified higher education expenses for 529 Plans now include tuition in connection with enrollment at an elementary or secondary public, private or religious school.
- **Limit on State and Local Tax Deductions**. The Act caps the deduction for payment of state and local taxes, including income taxes and property taxes, at $10,000 for married taxpayers filing jointly.

Planning Opportunity - If a state/local income or property tax is otherwise deductible if paid in 2017, paying the tax in 2017 rather than 2018 may be beneficial if the taxpayer expects to exceed the $10,000 cap for state and local taxes applicable for 2018 payments. However, consider potential AMT implications of this for 2017. Note that the Act denies a deduction in 2017 on payment of state or local income tax for a future taxable year. Therefore, prepayment of 2018 state income taxes will not be effective.

- **Alternative Minimum Tax**. The Act increases the exemption amount for the alternative minimum tax for married taxpayers filing jointly to $109,400.
- **Increase in Exclusion from Estate, Gift and Generation-Skipping Tax**. The Act increases the exclusion amount for estate tax, gift tax and generation-skipping transfer tax from $5,490,000 per person in 2017 to $10,000,000 (approximately $11,200,000 after adjustments for inflation) per person in 2018. As under current law, a surviving spouse may still elect to preserve and use a deceased spouse's unused exclusion amount, meaning a married couple with a combined estate up to $22,400,000 in value at the time of the survivor's death will not pay estate tax.

Planning Opportunity - Individuals who are no longer likely to have a taxable estate should consider amending their estate plan to focus on achieving a step-up in income tax basis to fair market value at their death on assets that have appreciated in value rather than minimizing estate tax.

CHANGES IMPACTING BUSINESSES

- **Lower Corporate Income Tax Rates**. Corporate income tax rates currently range from 15% to 35%. The Act applies a single flat rate of 21%. The Alternative Minimum Tax applicable to corporations is repealed under the Act. These provisions are not scheduled to expire.
- **Deduction for Pass-Through Entities**. The Act creates a 20% deduction for an individual, trust or estate receiving income from pass-through entities (such as partnerships and subchapter S

corporations) on qualified business income, subject to a number of limitations. The effect of the deduction is to lower the income tax payable by the owner of the business attributable to the profits of the business. This is one of the more complex sections of the Act. The Act provides that the deduction for a specified service business (such as healthcare, law, consulting and financial services, but excluding engineering and architecture) begins to phase out at $157,500 of taxable income for a single person and $315,000 for a married couple filing jointly. The deduction for a specified service business phases out over the next $100,000 of taxable income for married taxpayers filing jointly ($50,000 for other taxpayers). For a business that does not fall within the category of specified service businesses, limits are imposed on the deduction based on the amount of W-2 wages paid and depreciable assets owned by the business.

- **Bonus Depreciation**. The Act increases bonus depreciation for qualified assets from 50% to 100% and expands the definition of qualified assets to include used assets. Bonus depreciation is available for assets acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024 for certain property with longer production periods).
- **Section 179 Deduction**. The Act increases the Section 179 deduction limit from $500,000 under current law to $1,000,000.
- **Entertainment Expenses**. Deductions for entertainment, amusement and recreation expenses related to the active conduct of a trade or business are eliminated under the Act.
- **Net Interest Expense**. The Act limits the net interest expense deduction of a business to 30% of the business's adjusted taxable income. For pass-through entities, this limit will be determined at the entity level. An exemption from this limitation applies to a taxpayer (other than a tax shelter) with average annual gross receipts for the three-year period ending with the prior tax year that do not exceed $25 million. Other exceptions exist.
- **Like Kind Exchanges**. The Act limits non-recognition treatment to sales of real estate which is not held primarily for sale. Like-kind exchange treatment will not be available for tangible personal property (e.g., a car).
- **Net Operating Loss Deduction**. The Act limits the net operating loss carryover deduction to 80% of the taxpayer's taxable income determined without consideration of the net operating loss deduction.