The Tax Cuts and Jobs Act

Client Advisories

12.28.2017

The new tax bill was signed into law by the President on December 22. Unless noted otherwise, the changes apply to tax years beginning after December 31, 2017. Click on each title below to view a complete description of the changes for each topic.

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Changes Affecting Individuals

A. Tax Rates Generally

Tax Rates and Brackets. The new rates and brackets are these:
For joint filers and surviving spouses:

10% on the first $19,050 of taxable income

12% on taxable income from $19,050 to $77,400

22% on taxable income from $77,400 to $165,000

24% on taxable income from $165,000 to $315,000

32% on taxable income from $315,000 to $400,000

35% on taxable income from $400,000 to $600,000

37% on taxable income over $600,000

For singles:

10% on the first $9,525 of taxable income

12% on taxable income from $9,525 to $38,700

22% on taxable income from $38,700 to $82,500

24% on taxable income from $82,500 to $157,500

32% on taxable income from $157,500 to $200,000

35% on taxable income from $200,000 to $500,000

37% on taxable income over $500,000

For heads of household:

10% on the first $13,600 of taxable income

12% on taxable income from $13,600 to $51,800

22% on taxable income from $51,800 to $82,500

24% on taxable income from $82,500 to $157,500

32% on taxable income from $157,500 to $200,000

35% on taxable income from $200,000 to $500,000

37% on taxable income over $500,000

For marrieds filing separately:

10% on the first $9,525 of taxable income

12% on taxable income from $9,525 to $38,700

22% on taxable income from $38,700 to $82,500

24% on taxable income from $82,500 to $157,500

32% on taxable income from $157,500 to $200,000

35% on taxable income from $200,000 to $300,000

37% on taxable income over $300,000

For trusts and estates:

10% on the first $2,550 of taxable income

24% on taxable income from $2,550 to $9,150

35% on taxable income from $9,150 to $12,500

37% on taxable income over $12,500

Capital Gains. Capital gain rates remain unchanged - - 15% or 20%, depending on one's level of income. The 3.8% tax on net investment income continues unchanged.

The Kiddie Tax. The taxable income of a child which is attributable to earned income will be taxed using the rates for singles, while that which is attributable to unearned income will be taxed at the trust and estate rates - - the child's unearned income will no longer be taxed at the parents' rates.

Alternative Minimum Tax (AMT). The AMT on individuals has been retained, but one change was made in the method of computing it. AMT applies only to the excess of "alternative minimum taxable income" over an exemption amount. The Act significantly increased the exemption amount, which should result in fewer taxpayers being subject to the AMT.

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B. Personal Exemptions and Itemized Deductions

Personal Exemptions. Deductions for personal exemptions are no longer allowed.

Standard Deduction. In lieu of the itemized deductions which have been eliminated or limited (discussed below), the standard deduction has been increased to $24,000 for joint filers, $18,000 for heads of household and $12,000 for all others. There is no change to the current-law additional standard deductions for the blind and elderly. Additionally, the standard deduction is increased by a person's "net disaster loss."

Limit on Medical Expense Deductions. Historically, unreimbursed medical expenses were allowed as itemized deductions to the extent they exceeded 10% of one's AGI (7.5% of AGI for certain taxpayers). For years beginning after December 31, 2016 and ending before January 1, 2019, the limit is 7.5% of AGI for all taxpayers.

State and Local Tax Deductions. Itemized deductions for property taxes and state and local income taxes (or sales taxes in lieu of income taxes) are now limited to an aggregate of $10,000. Foreign real property taxes may not be deducted. That being said, property taxes (including foreign property taxes) and state and local sales taxes (but not income taxes) are deductible if paid or accrued in carrying on a trade or business.

Mortgage and Home Equity Indebtedness. Interest paid on home equity indebtedness is no longer deductible. The deduction for mortgage interest is limited to the interest incurred on up to $750,000 (previously, $1 million) of qualifying acquisition indebtedness incurred after December 14, 2017. The $1 million limitation continues to apply to taxpayers who refinance existing qualified residence indebtedness that was incurred before December 31, 2017, so long as the indebtedness resulting from the refinancing does not exceed the amount of the refinanced debt.

Charitable Contribution Deductions. For cash contributions to public charities and certain private foundations, the amount of the deduction has historically been limited to 50% of one's "contribution base." The new law allows those deductions up to 60% of the contribution base.

Contributions in Return for College Athletic Seating Rights. Charitable contribution deductions are no longer allowed for payments to institutions of higher education in exchange for which the donor receives the right to purchase tickets or seating at an athletic event. (Prior law allowed a deduction for 80% of the amount of such a contribution.)

Casualty and Theft Losses. Deductions for these types of losses are no longer allowed, except for casualty losses sustained in a federally-declared disaster.

Miscellaneous Itemized Deductions. Deductions are no longer allowed for miscellaneous itemized deductions (e.g., tax preparation expenses).

The Overall Limit on Itemized Deductions. Prior to the Act, higher-income taxpayers were subject to a limitation on the amount of their itemized deductions. Under the Act, this limitation no longer exists.

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C. Credits

Child Tax Credit. This credit has been increased from $1,000 to $2,000 per qualifying child under the age of 17. The credit historically began to phase out when AGI exceeded $110,000, $75,000 and $55,000 for joint filers, singles and marrieds filing separately, respectively. Those income limits have been substantially increased (making the credit available to many more people): $400,000 for joint filers and $220,000 for all others. In addition, a $500 credit is now permitted for certain non-child dependents.

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D. New Deductions and Special Income Items

Alimony. For divorce or separation agreements executed after December 31, 2018, or executed before that date but "properly" modified after it, alimony is no longer taxable to the recipient or deductible by the payor.

Deduction for Income from Pass-Through Entities. This one is not as simple as some have made it sound. In over-simplistic terms, 20% of pass-through income (i.e., income from sole proprietorships, partnerships, LLCs and S corporations) may be deducted by non-corporate taxpayers. The deduction is limited for persons whose taxable income exceeds certain levels ($315,000 for joint filers and $157,500 for others) - - their deduction is limited by the amount of wages paid by the flow-through entity and sometimes by the unadjusted basis of the business's tangible depreciable property. The deduction is not available for income earned in certain service business including medical, legal, accounting and consulting (though it is available for engineering, architecture and businesses that consist of investment-type activities).

Excess Business Losses. This is another new concept altogether - - it amounts to one more limitation on the ability to deduct losses. If an individual or other non-corporate taxpayer has an "excess business loss" (defined as the excess of aggregate deductions attributable to the taxpayer's trades or businesses over the sum of aggregate gross income or gains from the trades or businesses plus a threshold amount), the excess is carried forward and treated as part of the taxpayer's net operating loss. The threshold amount is $500,000 for joint filers and $250,000 for others. This limitation applies after the application of the passive loss rules.

Deferral Election for Qualified Equity Grants. Generally, an employee who receives employer stock in connection with the performance of services must recognize income in the year in which his/her right to stock is transferable or is not subject to a substantial risk of forfeiture. Effective with respect to stock attributable to options exercised or restricted stock units settled after December 31, 2017, a qualified employee may elect to defer recognition of the amount of income attributable to qualified stock received. If the election is made, the income must be included in the employee's income at the earliest to occur of five different events. The election is available for "qualified stock" attributable to a stock option, in which case, the option is not treated as a stock option, and the rules relating to stock options and related stock do not apply. In order for deferral to be available, stock of the employer corporation cannot be readily tradable on an established securities market, and the corporation must have a written plan under which not less than 80% of its employees who provide services in the United States are granted stock options or restricted stock units - - the latter requirement may negatively impact the utility of this election.

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E. Education

ABLE Accounts. These accounts allow individuals with disabilities and their families the ability, subject to an annual limit, to fund a tax-preferred savings account to pay for qualified disability-related expenses. The Act increases the limit for contributions by the designated beneficiary (i.e., the person with a disability), allows the designated beneficiary to claim the saver's credit for contributions made to his/her ABLE Account, imposes recordkeeping requirements and permits distributions from Section 529 Plans to be rolled into ABLE Accounts without penalty.

529 Plans. Section 529 Plans have historically been limited to providing benefits for certain costs of attending colleges, vocational schools and other postsecondary schools. Under the Act, these Plans may now be used to pay for costs of attending elementary or secondary public, private or religious schools, up to a $10,000 limit per year.

Student Loans Discharged. Gross income generally includes the discharge of indebtedness of the taxpayer. An exception exists for the forgiveness of certain student loans. The Act adds an additional exception for discharges of certain student loans where the discharge is on account of the death or total and permanent disability of the student.

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F. Miscellaneous Individual Tax Issues

Qualified Bicycle Commuting Exclusion. Prior to the Act, employees were allowed to exclude up to $20 per month in qualified bicycle commuting reimbursements. The exclusion has now been eliminated.

Moving Expense Reimbursements. Historically, employees have been allowed to exclude qualified moving expense reimbursements from income. That exclusion has now been repealed (meaning the reimbursements will now be taxable), except for reimbursements paid to members of the Armed Forces on active duty (and their spouses and dependents) who move pursuant to a military order and incident to a permanent change of station.

Moving Expense Deduction. Traditionally, taxpayers have been permitted to claim a deduction for moving expenses incurred in connection with starting a new job if the new workplace was at least 50 miles farther from a taxpayer's former residence than the former place of work. That deduction has now been eliminated, other than for members of the Armed Forces meeting the requirements in the preceding paragraph.

Combat Zone Treatment. Members of the Armed Forces serving in combat zones are afforded a number of tax benefits (e.g., exclusion of certain pay and special estate tax rules). Under the Act, combat zone benefits are extended for services provided on or after June 9, 2015 for the Sinai Peninsula of Egypt.

Qualified 2016 Disaster Distributions. The 10% tax on early withdrawals from qualified retirement plans will not apply to the first $100,000 of "qualified 2016 disaster distributions." The latter are defined as distributions from an eligible retirement plan made on or after January 1, 2016 and before January 1, 2018, to an individual whose principal place of abode at any time during 2016 was located in a 2016 disaster area and who sustained an economic loss by reason of the events that gave rise to the Presidential disaster declaration. Additionally, the income attributable to the distribution may be included in income ratably over three years, and the amount of the distribution may be recontributed to a retirement plan within three years. The Act permits retroactive plan amendments if certain requirements are met.

Self-Created Property Not Treated as a Capital Asset. Under the new law, capital asset status is not allowed for patents, inventions, models or designs (whether or not patented) and secret formulae or processes which are held either by the taxpayer who created the property or by a taxpayer with a substituted or transferred basis from the taxpayer who created the property.

Due Diligence Required for Claiming Head of Household Status. Paid return preparers are now subject to a $500 penalty for failure to exercise due diligence in determining a taxpayer's eligibility to file as head of household.

Carried Interest. In order for certain gains allocable to partnership interests received in connection with the performance of services to be taxed as long-term capital gains (rather than ordinary income), the assets giving rise to the gain must have been held for more than three years (rather than the traditional one year requirement). This rule applies to partnership interests of entities which conduct on a regular, continuous and substantial basis the activity of raising or returning capital and either (i) investing in specified assets, or (ii) developing specified assets. Specified assets means securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing.

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G. Estate and Gift Taxes

For estates of decedents dying and gifts made after December 31, 2017 and before January 1, 2026, the estate and gift tax exemption doubles from $5.6 million to $11.2 million.

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Changes Affecting Businesses

Corporate Tax Rate. For tax years beginning after December 31, 2017, the corporate tax rate will be a flat 21%.

Dividends Received Deduction. Corporations that receive dividends from other corporations are entitled to a deduction for dividends received. Congress has now reduced the amount of the deduction. If the corporation owns at least 20% of the stock of another corporation, the dividends received deduction is reduced from 80% to 65%, and the historic 70% deduction for all other corporations is reduced to 50%.

Alternative Minimum Tax. The AMT for corporations has been repealed.

Foreign Earnings. A dividend exemption for 100% of foreign-source dividends from foreign subsidiaries will apply to 10% U.S. shareholders. In addition, a one-time tax of 15.5% or 8% (depending on how the foreign earnings are held) will be imposed on accumulated foreign income of most foreign corporations in which a U.S. person owns a 10% voting interest, regardless of whether those earnings are repatriated or not.

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H. Expensing and Depreciation

Section 179 Expensing. The maximum amount a taxpayer may expense under Section 179 is increased to $1 million, and the phase-out threshold is increased to $2.5 million. Additionally, the definition of Section 179 property has been expanded to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging. Finally, the definition of qualified real property eligible for Section 179 expensing has been expanded to include the following improvements to nonresidential real property after the date the property was first placed in service: roofs, HVAC property, fire protection and alarm systems and security systems.

100% Cost Recovery Deduction. In the past, an additional first-year bonus depreciation 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. Under the new law, a 100% first-year deduction for the adjusted basis of property is allowed for qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023. This deduction is available for both new and used property.

Luxury Automobile Depreciation. For passenger automobiles placed in service after December 31, 2017, in tax years ending after that date, for which additional first-year depreciation is not claimed, the maximum amount of allowable depreciation is increased to: $10,000 for the year the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year and $5,760 for the fourth and later years in the recovery period.

New Farming Equipment. For property placed in service after December 31, 2017, in tax years ending after that date, the cost recovery period is shortened from seven to five years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence or other land improvement) used in a farming business, the original use of which begins with the taxpayer. Additionally, the use of the 150% declining balance depreciation method for property used in a farming business (for 3-, 5-, 7-, and 10-year property) has been repealed.

Recovery Period for Real Property. The cost recovery periods for most real property has been 39 years for nonresidential real property and 27.5 years for residential rental property. The more notable change made by the Act is that qualified improvement property (QIP) is now entitled to a 15-year recovery period (down from 39.5 years), straight-line depreciation and a 20-year ADS recovery period. QIP is any improvement to an interior portion of a building that is nonresidential real property if the improvement is placed in service after the date the building was first placed in service. QIP does not include any improvement which constitutes an enlargement of the building, an elevator or escalator, or the internal structural framework of the building.

Replanting Citrus Plants Lost Due to Casualty. The Act allows the costs of replanting citrus plants lost or damaged due to a casualty to be deducted by persons other than the taxpayer if certain conditions are met.

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I. Deductions and Exclusions

Deduction of Business Interest. Every business, regardless of its form, is now generally subject to the disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income.

Adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization or depletion and without the former Code Section 199 deduction (which has been repealed). Exception: this rule does not apply to taxpayers (other than tax shelters) with average annual gross receipts for the three-tax year period ending with the prior taxable year that do not exceed $25 million. Exceptions also apply for certain public utilities and electric cooperatives, real property trades or businesses that elect out, farming businesses that elect out and floor plan financing.

Net Operating Loss Deductions. For NOLs arising in years ending after December 31, 2017, the two-year carryback period has been repealed, except for those engaged in the business of farming. For losses arising in tax years beginning after December 31, 2018, the NOL deduction is limited to 80% of taxable income, and the NOL can be carried forward indefinitely.

Domestic Production Activities Deduction (DPAD). For tax years beginning after December 31, 2017, the DPAD is repealed for non-corporate taxpayers. For tax years beginning after December 31, 2018, the DPAD is repealed for C corporations.

Like Kind Exchanges. Effective for transfers after December 31, 2017, like kind exchange treatment is allowed only for real property that is not held primarily for sale. A transitional rule allows personal property to be exchanged tax-free for a short time if the relinquished property was disposed of, or the replacement property was acquired, on or before December 31, 2017.

Research and Experimentation (R&E) Expenses. For amounts paid or incurred in tax years beginning after December 31, 2021, "specified R&E expenses" must be capitalized and amortized ratably over a five-year period (15 years if conducted outside the U.S.). Specified R&E expenses include expenses for software development (with certain limitations) and exploration expenses incurred for ore or other minerals (including oil and gas).

Meals, Entertainment and Transportation. Deductions for entertainment expenses will not be allowed for amounts incurred or paid after December 31, 2017. The current 50% limit on the deductibility of business meals is expanded to meals provided through an in-house cafeteria or on the premises of the employer. Deductions for employee transportation fringe benefits (e.g., parking and mass transit) are no longer allowed, but the exclusion from income for those benefits remains in effect.

Fines and Penalties. For amounts paid after December 22, 2017, no deduction is allowed for amounts paid or incurred to, or at the direction of, a government or certain other entities in relation to the violation of any law or the potential violation of any law. Amounts paid as restitution or remediation, however, are deductible.

Sexual Harassment. Effective for amounts paid or incurred after December 22, 2017, no deduction is allowed for any settlement, payout or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement.

Employee Achievement Awards. Employee achievement awards are excludable from the employee's income. To qualify for exclusion, the awards must take the form of "tangible personal property." The Act clarifies that tangible personal property does not include cash, gift cards, gift certificates, vacations, meals, lodging, tickets for theater or sporting events, stock, bonds and the like.

Excessive Employee Compensation. It has long been the law that compensation paid to a covered employee of a publicly-traded corporation is limited to no more than $1 million per year. There are exceptions for certain forms of compensation (e.g., commissions and stock options). The Act repeals the exceptions - - those forms of compensation must now be taken into account in determining whether the $1 million limit has been exceeded.

Lobbying Expenses. Prior to the Act, no deduction was allowed for lobbying and political expenditures with respect to legislation and candidates for office. An exception existed for lobbying expenses incurred with respect to legislation before local government bodies - - those expenses were deductible. The Act repeals the exception, effective for amounts paid after December 22, 2017 - - those costs are now not deductible.

Orphan Drug Credit. In the past, a drug manufacturer could claim a credit equal to 50% of qualified clinical testing expenses. Under the Act, that percentage is reduced to 25%.

Rehabilitation Credit. The 10% credit for qualified rehabilitation expenditures with respect to a building placed in service before 1936 has been repealed, and a 20% credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure which can be claimed ratably over a five-year period beginning when the structure is placed in service.

Employer-Paid Family and Medical Leave. A new general business credit was created under the Act. The credit is equal to 12.5% of the amount of wages paid to qualifying employees during any period in which the employee is on FMLA if the rate of payment is 50% of the wages normally paid to an employee. The credit increases as the rate of payment exceeds 50%.

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J. Accounting Method Changes

Taxable Year of Inclusion. Taxpayers are now required to recognize income no later than the tax year in which such income is taken into account as income on an applicable financial statement. The Act also codifies the current deferral method of accounting for advance payments for goods and services provided in Rev. Proc. 2004-34.

Cash Method of Accounting. Under pre-Act law, corporations and partnerships with a corporate partner (other than qualified personal service corporations) were allowed to use the cash method of accounting only if their average annual gross receipts over a three-year period did not exceed $5 million. Under the Act, the cash method may be used by taxpayers (other than tax shelters) that satisfy a $25 million gross receipts test.

Accounting for Inventories. Historically, businesses that are required to use an inventory method must generally use the accrual method of accounting (an exception existed for certain smaller businesses). Under the new law, taxpayers that meet a $25 million gross receipts test are not required to account for inventories, but may use an accounting method for inventories that either treats inventories as non-incidental materials and supplies or conforms to the taxpayer's financial accounting treatment of inventories.

UNICAP Rules. The uniform capitalization rules generally require certain costs associated with real or tangible personal property manufactured by a business to be included in either inventory or capitalized into the basis of the property. Businesses with gross receipts over a three-year period of $10 million or less were not subject to the UNICAP rules. Under the Act, the $10 million gross receipts threshold is increased to $25 million.

Accounting for Long-Term Contracts. An exception from the requirement to use the percentage-of-completion method of accounting for long-term contracts has existed for construction companies whose gross receipts did not exceed a $10 million threshold. Generally, that threshold has been increased to $25 million for contracts entered into after December 31, 2017.

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K. Other Changes

Rollover of Publicly Traded Securities. The Act repeals the election available to corporations and individuals to roll over tax-free capital gains realized on the sale of publicly traded securities to the extent of the taxpayer's cost of purchasing common stock or a partnership interest in a specialized small business investment company.

Investment in Qualified Opportunity Zones. Effective on December 22, 2017, the Act provides a temporary deferral of inclusion in gross income for capital gains reinvested in a qualified opportunity fund and the permanent exclusion of capital gains from the sale or exchange of an investment in the qualified opportunity fund. The Act allows for the designation of certain low-income community population census tracts as qualified opportunity zones.

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Changes Affecting Pa

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