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Tax Notes

House and Senate Conferees Sign and Release the *Tax Cuts and Jobs Act Bill*

The House and Senate conferees signed and released a Conference Agreement which reconciled the differences in their respective versions of the "Tax Cuts and Jobs Act" (H.R. 1), on December 15, 2017. The combined report is expected to be considered and voted upon by the full House and Senate before the end of this week. If approved, President Trump is expected to sign the bill into law before the Christmas holiday.

We are summarizing in this newsletter some of the key provisions for individuals and businesses as well as some international provisions.

Individuals

Please note that all of the individual tax changes will expire after 2025.

Tax Rates: There will be seven tax brackets ranging from 10 percent to the top bracket of 37 percent. The top rate of tax has been lowered from 39.6 percent.

Standard Deduction: Temporarily to be set at $24,000 for joint filers, $18,000 for head of household filers, and $12,000 for single filers.

Personal Exemptions: Would be repealed.

Child Tax Credit: Temporarily increased from $1,000 to $2,000, and up to $1,400 would be refundable.

Itemized Deductions: Have been slashed beginning 2018 as follows:

> State and Local Taxes — Under the final bill, only $10,000 in property, state and local taxes, and sales taxes may be deducted. Individuals would not be able to deduct in 2017 prepaid 2018 state income taxes.
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> Mortgage Interest — Limited to interest paid on acquisition indebtedness up to $750,000. Second home indebtedness would be eligible within this dollar limitation. Interest on home equity indebtedness will no longer be deductible. For acquisition indebtedness incurred before December 15, 2017, the conference bill allows current homeowners to keep the current limitation of $1 million ($500,000 in the case of married taxpayers filing separately).
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> Miscellaneous Itemized Deductions — Suspends the deductions that were previously subject to the 2 percent of AGI floor.

Individual Alternative Minimum Tax: Would remain; however, the exemption amount will be increased and the AGI phase-out will begin at a much higher level. The conference bill would temporarily increase the exemption amount to $109,400 for married filing jointly and $70,300 for others. The phase-out of the exemption starts at $1 million of AMT income for joint filers and at $500,000 for others.

Estate Tax: The bill would double the current estate and gift tax exemption from $5 million to $10 million, indexed for post-2011 inflation adjustments. The scheduled exemption for 2018 is $5.6 million per person. Thus, the 2018 exemption could exceed $11 million.

Alimony: Eliminates the deduction for alimony payments under divorce or separation agreements entered into or modified after December 31, 2018. Payments will not be treated as income for the recipient spouse either.

Business

Tax Rate: A new corporate tax rate of a flat 21 percent would be effective January 1, 2018.

Corporate AMT: Would be repealed.

Corporate Net Operating Loss Carryforwards: Would be limited to 80 percent of taxable income. Carryforwards will be allowed for an indefinite period subject to the 80 percent limitation. The two-year carryback and special NOL carryback provisions would be repealed.

Bonus Depreciation: The bill would increase the expensing allowance from 50 to 100 percent for property placed in service after September 27, 2017 through 2022 and removes the “original use” requirement. The amount of allowable bonus depreciation would then be phased down over four years: 80 percent would be allowed for property placed in service in 2023; 60 percent in 2024; 40 percent in 2025; and, 20 percent in 2026.

Interest Deductions: The conference bill generally caps the deduction for net interest expenses at 30 percent of adjusted taxable income, among other criteria. Exceptions would exist for small businesses, including an exemption for businesses with average gross receipts of $25 million or less. Any disallowed interest deductions could be carried forward indefinitely.

Pass-Through Businesses: The bill provides for a 20 percent deduction on domestic “qualified business income” (“QBI”) generated by a partnership, S Corporation or sole proprietorship — subject to certain limitations and income thresholds. QBI includes any trade or business other than specified service businesses (defined below) and does not include reasonable compensation of an S corporation shareholder nor guaranteed payments to partners.

Limit Based on Wages and Capital: For taxpayers whose taxable income does not exceed $157,500 for individuals ($315,000 if married filing jointly) there are no limitations. Above those thresholds, the amount of the deduction is limited to the greater of 50 percent of the W-2 wages, or the sum of 25 percent of the W-2 wages plus 2.5 percent of the unadjusted basis of all qualified property. Only those wages that are properly allocable to qualified business income are taken into account. Qualified property includes depreciable tangible property.

Special Further Limitation for Specified Service Businesses: The deduction does not apply to "specified service businesses," except for taxpayers whose taxable income does not exceed $207,500 (for individuals) or $415,000 (if married filing jointly). The benefit of the deduction is phased out for these taxpayers over a $50,000 range ($100,000 if joint return) for taxable income exceeding the $157,500 for individuals, and $315,000 if married filing jointly. A "specified service business" means any trade or business activity involving the performance of services in the fields of health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services, investment management, trading, dealing in securities, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its owners or employees. It does not include engineering or architecture trades or businesses.

International Provisions

The Conference Agreement moves the United States into a territorial system.

Dividend Received Deduction: In general, the bill provides for a 100 percent exemption for Foreign Source Dividends from foreign corporations in which the U.S. corporation owns at least 10 percent.

Mandatory Tax on Tax-Deferred Foreign Earnings: The Conference Agreement provides for a one-time transitional tax on 10 percent or more U.S. shareholder's pro rata share of a foreign corporation's post-1986 tax-deferred earnings. The tax rate is 15.5 percent on earnings attributable to cash and cash equivalents and other short-term assets and 8 percent on remaining assets.

Foreign Tax Credit (FTC): No FTC or deduction would be available for any taxes paid for earnings attributable to exempt foreign dividends.

Contact Us

PKF O'Connor Davies is closely tracking the tax bill as it passes through the legislative process. It is expected that the law will be passed and signed into law by the end of this week. If this is the case, over the coming weeks, we will be publishing articles on the specific details on all changes in the law, our observations, recommendations and planning ideas.

As advertised, this is the most significant tax law change in a generation or more. Don't hesitate to reach out to your PKF O'Connor Davies tax advisor to see how the changes may affect your tax situation. We are here to help.