



CPAs & BUSINESS ADVISORS

TAX REFORM: WHAT IT DOES, WHAT IT MEANS TO YOU

DISCLAIMER

These materials, and the accompanying oral presentation, are for educational purposes only and are not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

This information is of a general nature and based on authorities that are subject to change.

THE SCORE TODAY

- A House-Senate conference committee has released a bill settling differences passed by each house.
- Changes made to the bill appear to have won over wavering Senators, making passage probable.
- Votes are expected as soon as Tuesday.
- The President is expected to sign the bill.

THE GOALS OF TAX REFORM

- Reduce taxes for “ordinary hard working Americans.”
- Make the tax code more “fair” and “simple”- file on a “single sheet of paper.”
- Cut taxes on American businesses to restore jobs and be more globally competitive.
- Encourage corporations to repatriate earnings held overseas.

From President Trump’s speech on September 27, 2017

THE MATH OF TAX REFORM

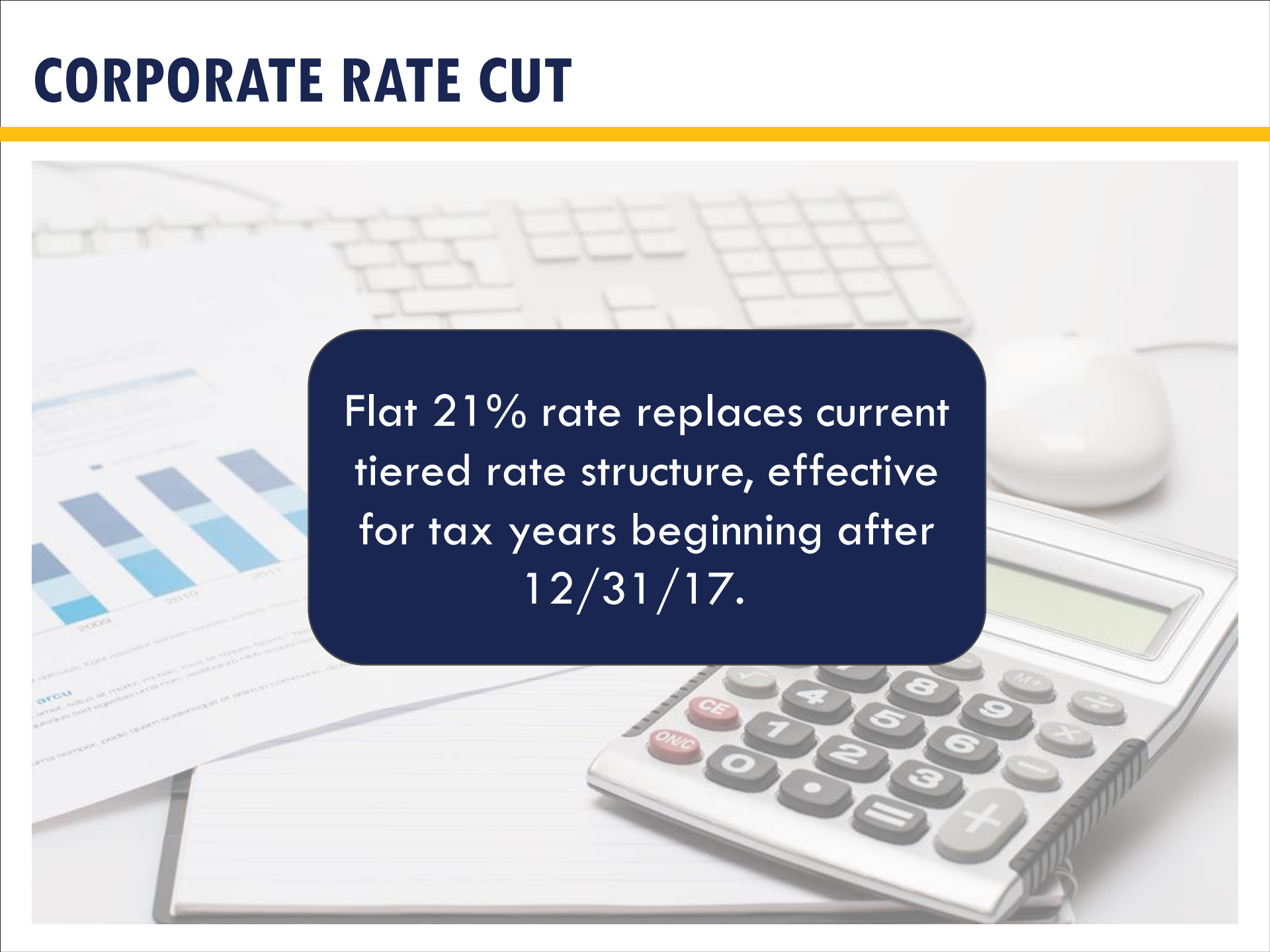
- Impact of budget reconciliation in Senate:
 - Avoid filibuster / pass with simple majority vote.
 - Budget resolution – limit increase to deficit to \$1.5T over 10 years.
 - Remain budget neutral after 2027.
- Preliminary score by JCT:

	JCT's Estimate of Budget Effects of	
	TCJA f/y 2018 - 2027	
<u>Provisions</u>	<u>(in billions)</u>	
Corporate tax rate drop to 21%	\$	(1,348.5)
Individual reforms (temporary)	\$	(712.1)
Pass-through 20% deduction (temporary)	\$	(414.5)
International reforms (excl. repat \$)	\$	(14.4)
Business reforms	\$	694.7
Deemed repatriation of foreign earnings	\$	338.8
Effect on federal budget f/y 2018 - 2027	\$	(1,456.0)



CORPORATE AND INDIVIDUAL TAX RATES

CORPORATE RATE CUT

The background image is a soft-focus photograph of a desk setup. It includes a white computer keyboard, a white mouse, a silver calculator with a green display, and a document with a blue bar chart. The bar chart has three bars labeled '2009', '2010', and '2011'. The document also has some text, including the word 'arcu' and some numbers. A dark blue rounded rectangle is overlaid on the center of the image, containing white text.

Flat 21% rate replaces current
tiered rate structure, effective
for tax years beginning after
12/31/17.

2017 RATES (JOINT FILERS)

Table 2. Married Filing Joint Taxable Income Tax Brackets and Rates, 2017

Rate	Taxable Income Bracket	Tax Owed
10%	\$0 to \$18,650	10% of taxable income
15%	\$18,650 to \$75,900	\$1,865 plus 15% of the excess over \$18,650
25%	\$75,900 to \$153,100	\$10,452.50 plus 25% of the excess over \$75,900
28%	\$153,100 to \$233,350	\$29,752.50 plus 28% of the excess over \$153,100
33%	\$233,350 to \$416,700	\$52,222.50 plus 33% of the excess over \$233,350
35%	\$416,700 to \$470,700	\$112,728 plus 35% of the excess over \$416,700
39.60%	\$470,700+	\$131,628 plus 39.6% of the excess over \$470,700

NEW (2018) INDIVIDUAL RATES: JOINT FILERS

If taxable income is:	Then income tax equals:
<i>Married Individuals Filing Joint Returns and Surviving Spouses</i>	
Not over \$19,050	10% of the taxable income
Over \$19,050 but not over \$77,400	\$1,905 plus 12% of the excess over \$19,050
Over \$77,400 but not over \$165,000	\$8,907 plus 22% of the excess over \$77,400
Over \$165,000 but not over \$315,000	\$28,179 plus 24% of the excess over \$165,000
Over \$315,000 but not over \$400,000	\$64,179 plus 32% of the excess over \$315,000
Over \$400,000 but not over \$600,000	\$91,379 plus 35% of the excess over \$400,000
Over \$600,000	\$161,379 plus 37% of the excess over \$600,000

NEW (2018) INDIVIDUAL RATES: SINGLE FILERS

If taxable income is:	Then income tax equals:
<i>Single Individuals</i>	
Not over \$9,525	10% of the taxable income
Over \$9,525 but not over \$38,700	\$952.50 plus 12% of the excess over \$9,525
Over \$38,700 but not over \$82,500	\$4,453.50 plus 22% of the excess over \$38,700
Over \$82,500 but not over \$157,500	\$14,089.50 plus 24% of the excess over \$82,500
Over \$157,500 but not over \$200,000	\$32,089.50 plus 32% of the excess over \$157,500
Over \$200,000 but not over \$500,000	\$45,689.50 plus 35% of the excess over \$200,000
Over \$500,000	\$150,689.50 plus 37% of the excess over \$500,000



SPECIAL RULES FOR INDIVIDUAL BUSINESS INCOME

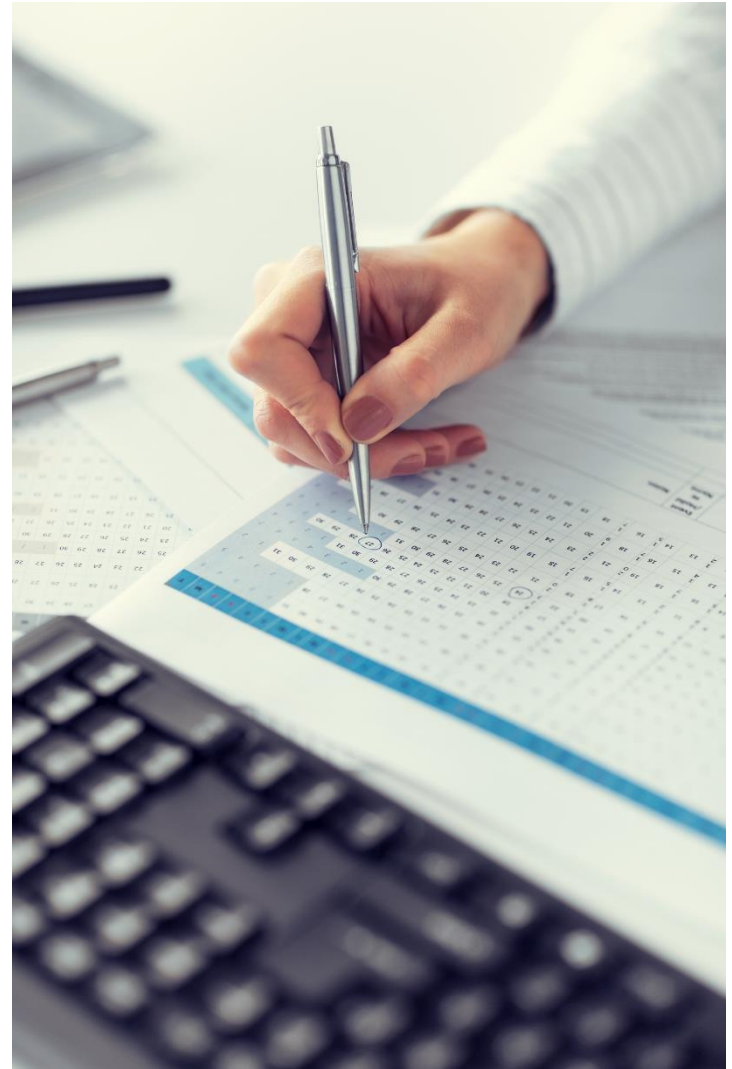
20% “PASS-THROUGH” DEDUCTION (SEC. 199A)

Sec. 199A provides deduction of 20% of “qualified business income.”

The effect is to make such income 20% tax-exempt.

The deduction is available for trade or business income taxable on 1040s, whether from a K-1, Schedule C, Schedule E, or Schedule F.

The deduction is subject to important limits.



ELIGIBLE INCOME

Qualified business income is made up of income and expense items of a qualified trade or business during the year. It also includes “qualified REIT dividends” and qualified publicly-traded partnership income.

A qualified trade or business excludes “specified services,” which are:

any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees.

This restriction doesn't apply when income is below a “threshold amount,” discussed later.

NON-QUALIFYING INCOME

Qualifying income excludes

- Capital gains and losses.
- Dividends (other than qualified REIT dividends).
- Interest, other than trade or business interest (financial institution interest income does qualify).
- Commodity gains, other than trade or business income
- Non-hedging currency and derivative gains.
- Annuity income

It appears that 1231 gains also do not qualify. The Conference Report says qualifying income does not include “any item **taken into account** in determining net long-term capital gain or net long-term capital loss” (Conference explanation, page 30).

LIMITS ON THE SEC. 199A DEDUCTION

For taxpayers with taxable income above the “threshold amounts,” the deduction is limited to the greater of:

- 50% of W-2 wages included in trades or businesses of the taxpayers, or
- The sum of 25% of W-2 wages and 2.5% percent of the taxpayer’s unadjusted basis in “qualified property”

“Qualified property” is depreciable property held by the business at the end of the taxable year whose depreciation life has not expired by the end of the taxable year. For this purpose, the depreciable life of the property is the property’s regular tax life, but not less than 10 years.

SPECIAL ELIGIBILITY AT LOWER INCOME LEVELS

The restrictions on “specified service income” and W-2/Capital Base ceilings on the deduction are waived for income below “threshold amounts.” These are:

- Unmarried taxpayers and married separate filers: Adjusted taxable income of up to \$157,500, phasing out over the next \$50,000 of income
- Joint filers: Adjusted taxable income up to \$315,000, phasing out over a the next \$100,000.

These income tests are applied at the individual level for partners and S corporation shareholders.

TRUST QUALIFICATION

While estates and trusts were excluded from Sec. 199A benefits under the House and Senate bills, they do qualify for the deduction under the conference agreement.

- This is a big deal for “Electing Small Business Trusts” owning S corporation stock.
- It also effects many family trusts owning inherited business and farm property.

REASONABLE COMPENSATION



Anti-abuse provisions provide exclusion of “reasonable compensation” to the taxpayer for services rendered and partnership guaranteed payments from the reduced rate; enhanced penalties.

REASONABLE COMPENSATION

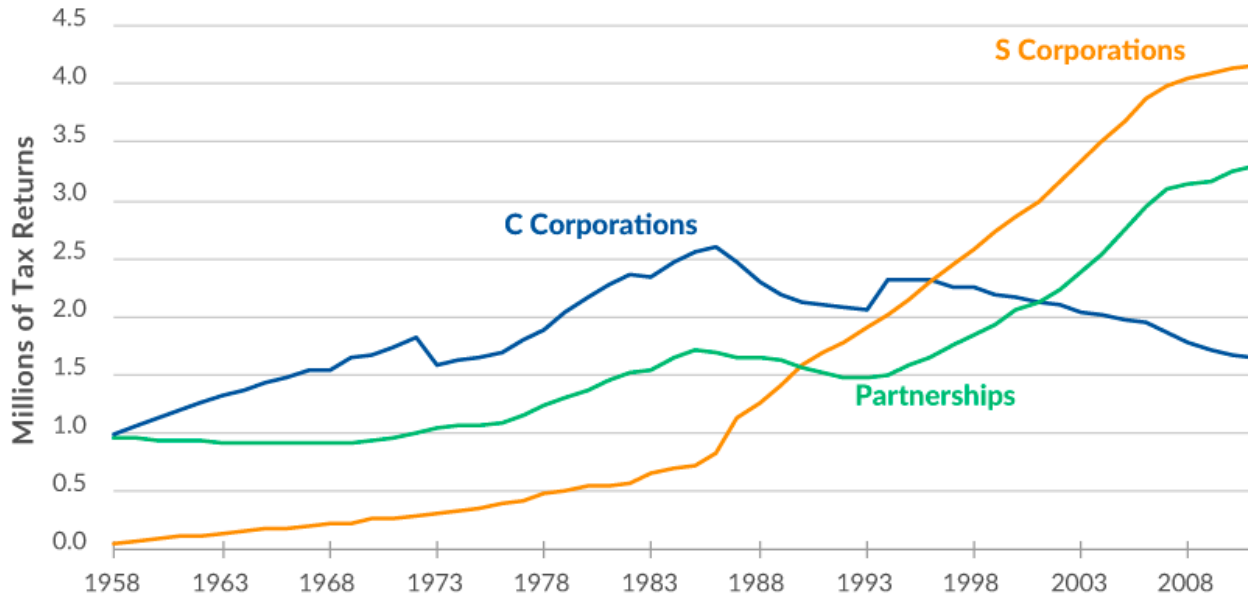
This promises to be an area of contention and uncertainty.

- S corporation “reasonable compensation” has been the subject of IRS audit attention, as taxpayers minimize W-2 wages to reduce payroll tax. This raises the stakes for such exams.
- Partnership “reasonable compensation” through guaranteed payments is an area with almost no precedent or guidance.
- Will the IRS attempt to impose “reasonable compensation” on Schedule C and Schedule F filers?

IS IT TIME TO RECONSIDER THE C CORPORATION?

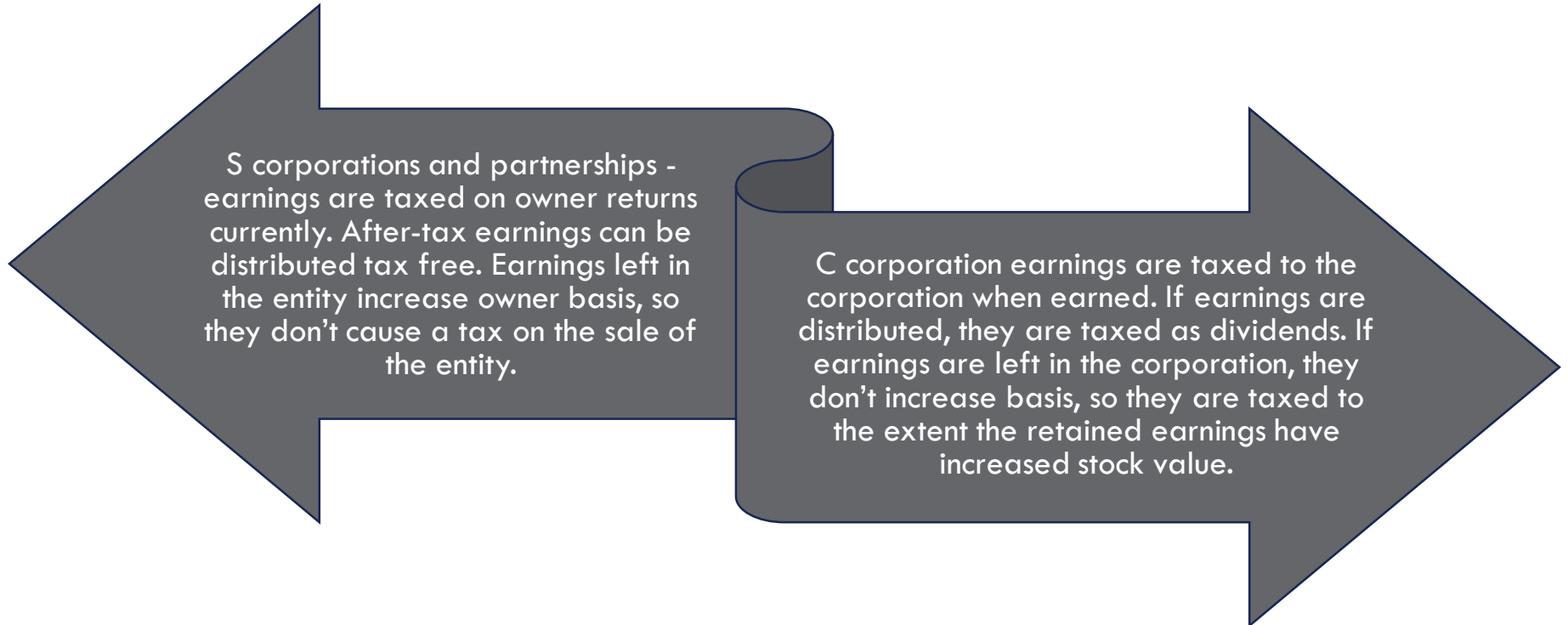
C corporations have fallen out of favor under the 1986 Code

Figure 1. Number of C Corporations Declining While Pass-Throughs Increase



Source: IRS.

WHY? THE C CORPORATION DOUBLE TAX



S corporations and partnerships - earnings are taxed on owner returns currently. After-tax earnings can be distributed tax free. Earnings left in the entity increase owner basis, so they don't cause a tax on the sale of the entity.

C corporation earnings are taxed to the corporation when earned. If earnings are distributed, they are taxed as dividends. If earnings are left in the corporation, they don't increase basis, so they are taxed to the extent the retained earnings have increased stock value.

DOES THE 21% CORPORATE RATE CHANGE EVERYTHING?

Joint-filer Taxable income	Marginal 100% rate	C corp rate	Distribution of after-tax C-corp income	Dividend Rate	Effective Dividend Rate	Combined Corp-Ind Rate
-	10.0%	21%	79%	0.0%	0.000%	21.0000%
19,050	12.0%	21%	79%	0.0%	0.000%	21.0000%
77,400	22.0%	21%	79%	15.0%	11.850%	32.8500%
165,000	24.0%	21%	79%	15.0%	11.850%	32.8500%
226,000	24.0%	21%	79%	18.8%	14.852%	35.8520%
315,000	32.0%	21%	79%	18.8%	14.852%	35.8520%
400,000	35.0%	21%	79%	18.8%	14.852%	35.8520%
479,000	35.0%	21%	79%	23.8%	18.802%	39.8020%
600,000	37.0%	21%	79%	23.8%	18.802%	39.8020%

)

COMPARING INDIVIDUAL RATE TO DOUBLE-TAXED CORPORATE RATE – CONFERENCE AGREEMENT

Business income

Joint-filer Taxable income	Effective Individual Rate	Combined Corp-Ind Rate
-	8.00%	21.0000%
19,050	9.60%	21.0000%
77,400	17.60%	32.8500%
165,000	19.20%	32.8500%
226,000	19.20%	35.8520%
315,000	25.60%	35.8520%
400,000	28.00%	35.8520%
479,000	28.00%	39.8020%
600,000	29.60%	39.8020%

A PLACE FOR “SHELTER?”

Are C Corporations the new tax shelter for investment income?

PERSONAL HOLDING COMPANY TAX

20% tax on
“undistributed
personal holding
company income”

Effect is to force
distribution of
investment income

INTEREST TAX RATES, CONFERENCE AGREEMENT

Interest income

Joint-filer Taxable income	Effective Individual Rate	Combined Corp-Ind Rate
-	10.00%	21.0000%
19,050	12.00%	21.0000%
77,400	22.00%	32.8500%
165,000	24.00%	32.8500%
226,000	27.80%	35.8520%
315,000	35.80%	35.8520%
400,000	38.80%	35.8520%
479,000	38.80%	39.8020%
600,000	40.80%	39.8020%

ACCUMULATED EARNINGS TAX

20% tax on “excess accumulated taxable income” of C corporations

SECTION 1202 EXCLUSION

Sec. 1202 Exclusion
for certain C
corporation gains

Unavailable for most
service businesses,
banking or other
finance business,
farming, extraction,
hotels, motels or
restaurants.

Permanent tax-free
treatment for gains
on some original-issue
C corporation stock
held for at least five
years.



SUMMARY: THE FUTURE OF C CORPORATIONS



Image by Hartmut Inerle under Creative Commons license



CHANGES TO INDIVIDUAL TAX DEDUCTIONS / CREDITS

THE COMING NEW WORLD OF INDIVIDUAL TAXES



Big increase in standard deduction.

Elimination or reduction of categories of itemized deductions.

Elimination of personal exemptions.

Increased child tax credit and new individual credit.

ITEMIZED DEDUCTIONS SLATED FOR ELIMINATION OR SIGNIFICANT REDUCTION INCLUDE:

Casualty and theft losses


State and local taxes

Miscellaneous deductions for items such as tax prep fees, investment expenses, and employee business expenses

STANDARD DEDUCTIONS

- Conference bill increases the standard deduction to \$24,000 for married individuals filing a joint return, \$18,000 for head-of-household filers, and \$12,000 for all other individuals.
- It indexes the standard deduction for inflation using the C-CPI-U for taxable years beginning after December 31, 2018.

MEDICAL EXPENSES



While the House bill would have repealed the deduction, the Conference bill retains it and lowers the AGI floor from the current 10% to 7.5% for **2017** and 2018

CASUALTY AND THEFT LOSSES

Repeals the deduction after 2017 except for Presidentially-declared disasters.

STATE AND LOCAL TAXES

- Conference bill repeals the itemized deduction for state and local taxes, including income and property taxes, effective for 2017, with the exception of a \$10,000 annual allowance.
- The allowance allows a maximum \$10,000 deduction for state and local non-business property and income taxes, or, at the taxpayer's option, property and sales taxes.
- Same \$10,000 limit for joint filers and single taxpayers.
- Neither bill allows a deduction for individual state income taxes attributable to pass-through or sole proprietorship income.

HOME MORTGAGE INTEREST

Deduction limited to \$750,000 principal on new home acquisition debt incurred after 12/15/17.

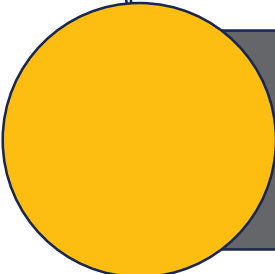
Home equity debt deduction “suspended” from 2018 through 2025.



MISCELLANEOUS DEDUCTIONS



Conference bill repeals deductions for tax preparation fees and unreimbursed employee business expenses.



The bill also repeals the deduction for expenses for the production or collection of income, as well as other deductions subject to the 2% floor.



The bill sunsets these disallowances after 2025.

PHASE-OUT OF ITEMIZED DEDUCTIONS, ETC.?

Gone

WHAT THIS MEANS FOR 2017 YEAR-END PLANNING



- Non-AMT taxpayers should project and pay their 2017 state and local income taxes before year-end. Maybe 2018 property taxes too depending on lien and assessment date.
- Will you ever itemize again? Many taxpayers will never have another Schedule A without the state income tax deduction. Such taxpayers should consider accelerating 2018 charitable deductions to 2017. Same for any other itemized deductions.

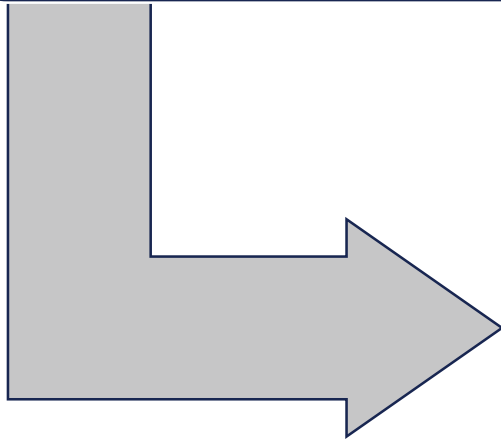
WHAT THIS MEANS FOR 2017 YEAR-END PLANNING



- The bill specifically bans a 2017 deduction for the prepayment of 2018 state and local income taxes.

WHAT IT MEANS FOR FUTURE TAX PLANNING

Home Equity Loans: no more tax advantage.



Bunching of deductions might become popular
- examples could include making charitable donations every two years.



EQUIPMENT AND BUILDINGS

BONUS DEPRECIATION

Placed in Service Year ⁵⁰⁰	Bonus Depreciation Percentage	
	Qualified Property in General/Specified Plants	Longer Production Period Property and Certain Aircraft
Portion of Basis of Qualified Property Acquired after Sept. 27, 2017		
Sept. 28, 2017 – Dec. 31, 2022	100 percent	100 percent
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent ⁵⁰²
2028 and thereafter	None	None

QUALIFIED PROPERTY



Used property:

Conference bill removes the requirement that the original use of qualified property must commence with the taxpayer (i.e., allows the additional first-year depreciation deduction for new and used qualified property).

Dealer property:

Bonus depreciation is unavailable for many taxpayers eligible to deduct “floor plan” interest expense.

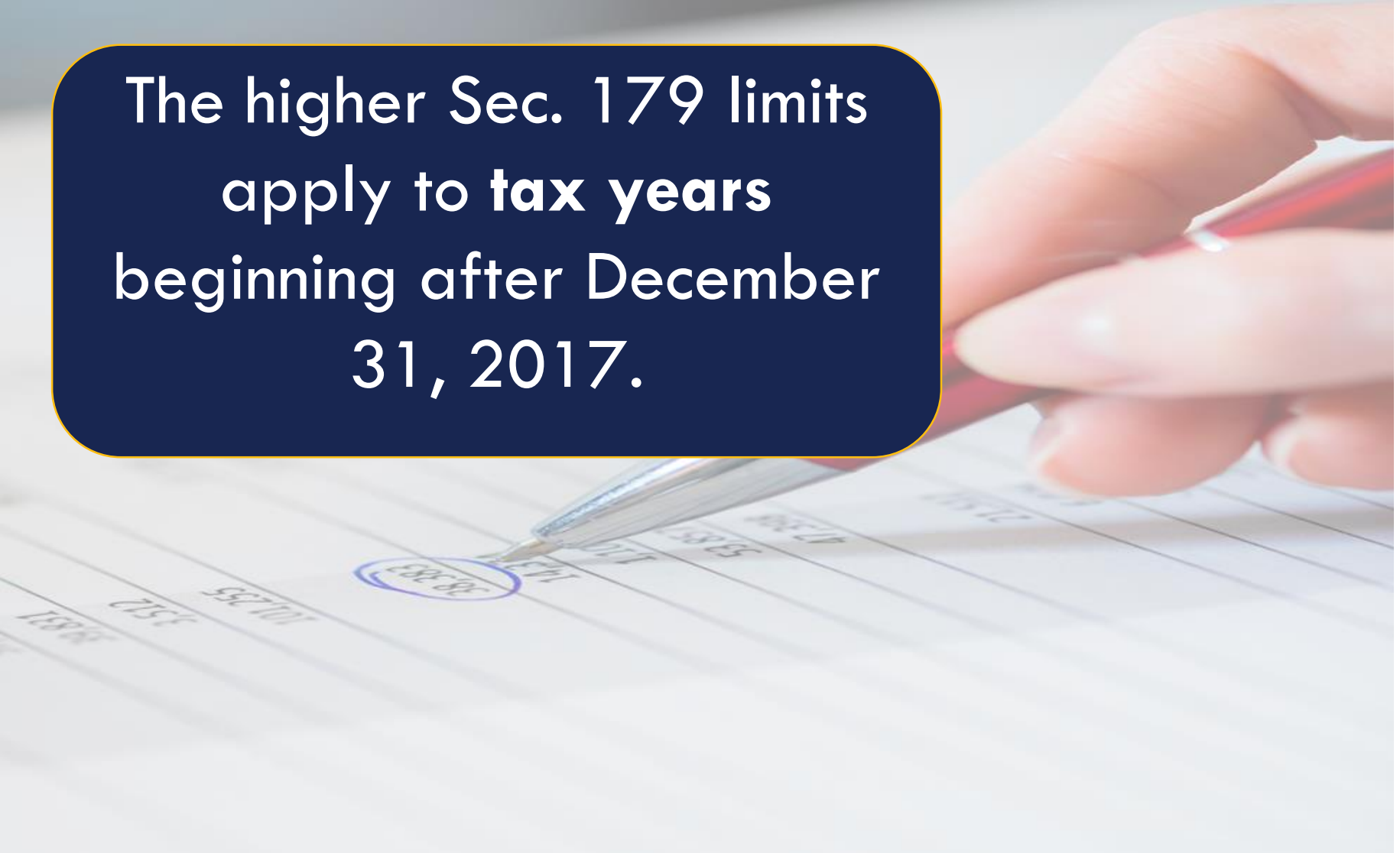
SECTION 179 DOLLAR LIMITS

Sec. 179

- Increases the maximum amount a taxpayer may expense under section 179 to \$1,000,000, and the phase-out threshold amount to \$2,500,000, for taxable years beginning after 2017.
- Indexes such amounts, as well as the \$25,000 sport utility vehicle limitation, for inflation for taxable years beginning after 2018.

SECTION 179 EFFECTIVE DATES

The higher Sec. 179 limits
apply to **tax years**
beginning after December
31, 2017.



CHANGES IN DEPRECIATION LIVES AND METHODS

- Conference bill eliminates slower depreciation for farm property.
- Conference bill makes “qualified improvement property” subject to a 15-year life.
- Conference bill eliminates special rules for qualified restaurant property.
- While Senate bill would have reduced depreciable life of buildings to 25 years, the current 27.5/39-year lives were retained in the Conference bill.

WHAT IT MEANS FOR YEAR-END PLANNING

Buying qualifying property?

- Go for it in 2017.

Building a stand-alone restaurant?

- Get 'er done this year.

Watch the “years beginning after” thing for Sec. 179.

WHAT IT MEANS FOR FUTURE PLANNING

Cost segregation will be a great investment.



INTERNATIONAL TAXATION

INTERNATIONAL TAX

- “Territorial” tax implemented by a 100% dividends received deductions by US corporations from foreign corporations
- Post 1986 earnings of controlled foreign corporations will be taxed at 15.5% to the extent of foreign cash equivalent assets. Other foreign earnings would be taxed at 8%.
- The US shareholder may elect to defer the tax over eight years. If the US shareholder is an S corporation, the shareholders will be allowed to make the election.
- Other provisions impose excise taxes for items like payments for intellectual property.



OTHER ITEMS

ALTERNATIVE MINIMUM TAX

House bill:

Repeals current
AMT for individuals
and corporation.

Senate Bill:

Retains AMT for
individuals and
corporations;
increases individual
AMT exemption.

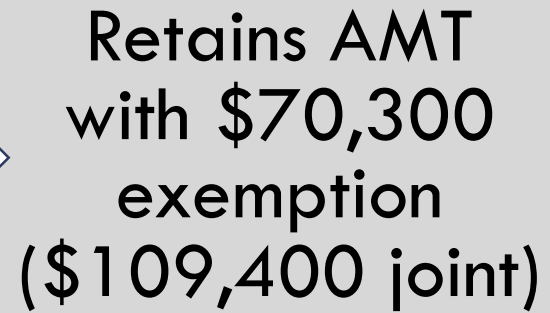
AMT IN CONFERENCE BILL



AMT IN CONFERENCE BILL



Individuals:

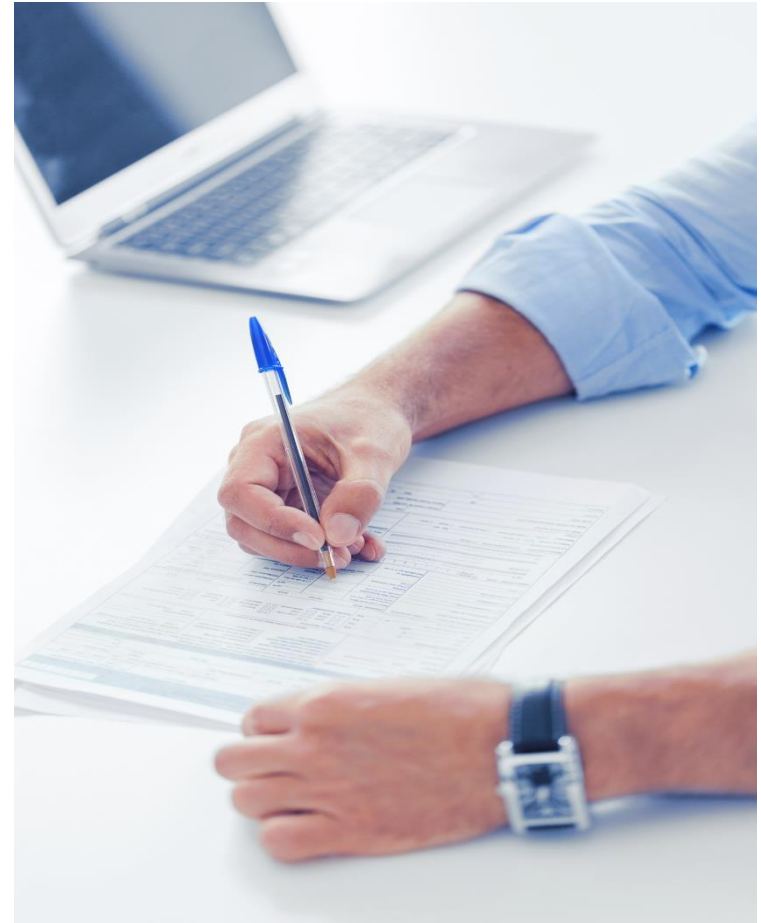


Retains AMT
with \$70,300
exemption
(\$109,400 joint)

Exemption begins to phase out at \$500,000 AGI, or
\$1 million for joint filers

LIKE-KIND EXCHANGES

Bills limits like kind exchanges to real property for post-12/31/17 exchanges. A transition rule applies to deferred or reverse exchanges started before 12/31.



CHANGES IN HOME SALE GAIN EXCLUSION

No change

- While both House and Senate bills proposed to cut back home sale benefits, the Conference bill makes no changes to current rules.

ESTATE TAX

- Conference bill doubles the basic exclusion amount for estate and gift tax purposes from \$5 million to \$10 million (indexed for inflation occurring after 2011) for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026.
- This makes the 2018 individual lifetime exclusion \$11.2 million taking the inflation adjustments into account.

DPAD



Repeals the “Section
199” Domestic
Production Activity
Deduction

CASH METHOD EXPANSION

The Conference bill increases the current \$10 million gross receipts limit for cash-basis taxpayers to \$25 million.



INVENTORY AND SECTION 263A SMALL ENTITY EXCLUSION

The Conference bill allows small entities to either treat inventories as supplies or treat them under their financial statement method, and it would exclude them from the Sec. 263A “inventory capitalization” rules. These rules apply to businesses with gross receipts under \$25 million.

The change is considered an accounting method change approved by the IRS.

Effective for years beginning after 12/31/17.

BUSINESS INTEREST DEDUCTION LIMITS

Conference bill:

- Limits interest deduction to the sum of (i) the business interest income of the taxpayer for the taxable year, (ii) 30 percent of the adjusted taxable income of the taxpayer for the taxable year, and (iii) the floor plan financing interest of the taxpayer for the taxable year.
- Defines adjusted taxable income by starting with taxable income without regard to non-business items, interest, and NOLs.
- For 2018-2021, “adjusted taxable income” is computed without regards to depreciation, amortization and depletion.
- After 2021, adjusted taxable income includes depreciation, amortization and depletion deductions.
- The 20% Sec. 199A deduction is ignored.
- A special rule allows a deduction of interest for floor-plan financing.
- Excess interest is deferred and added to subsequent year computations.

EXECUTIVE COMPENSATION

- Expands the \$1 million deduction limit on compensation paid to top executives of publicly held companies after 2017.
- The exception for performance-based goals is eliminated.
- Definition of covered employees modified to include all executives once identified and CFOs.
- Transition rule for performance-based agreements in place on November 2, 2017.

ENTERTAINMENT EXPENSES

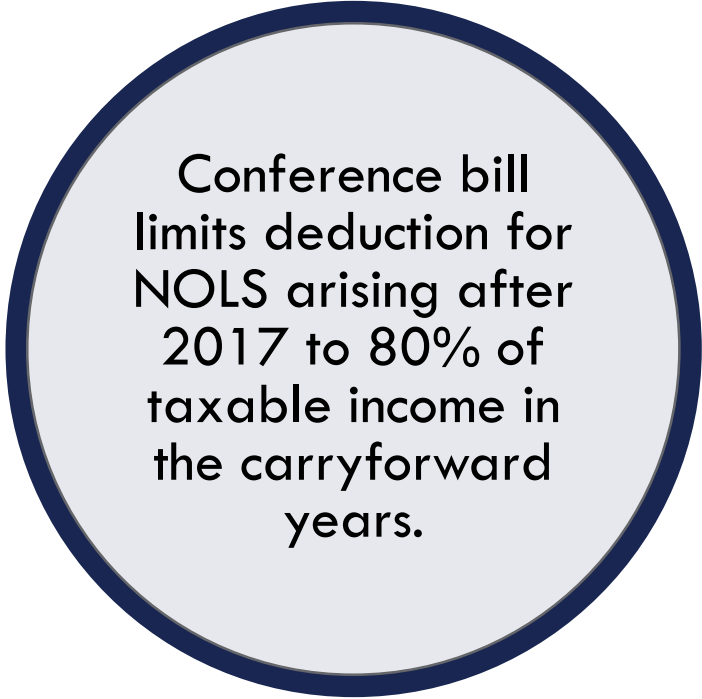
- Conference agreement eliminates deductions for business entertainment and membership dues.
- Employee achievement awards may not be deducted or excluded from employee's income if the award is paid in cash, gift cards, meals, lodging, tickets, securities or similar items.
- Employer provided eating facilities will be subject to the 50% deduction limitation; after 2025 deductions are completely disallowed for employer-provided eating facilities and meals provided for the convenience of the employer.

NET OPERATING LOSS CARRYBACKS

Conference bill eliminates NOL carrybacks, with exceptions:

Bill allows a two-year carryback in the case of certain disaster losses incurred in the trade or business of farming.

NET OPERATING LOSS CARRYFORWARDS



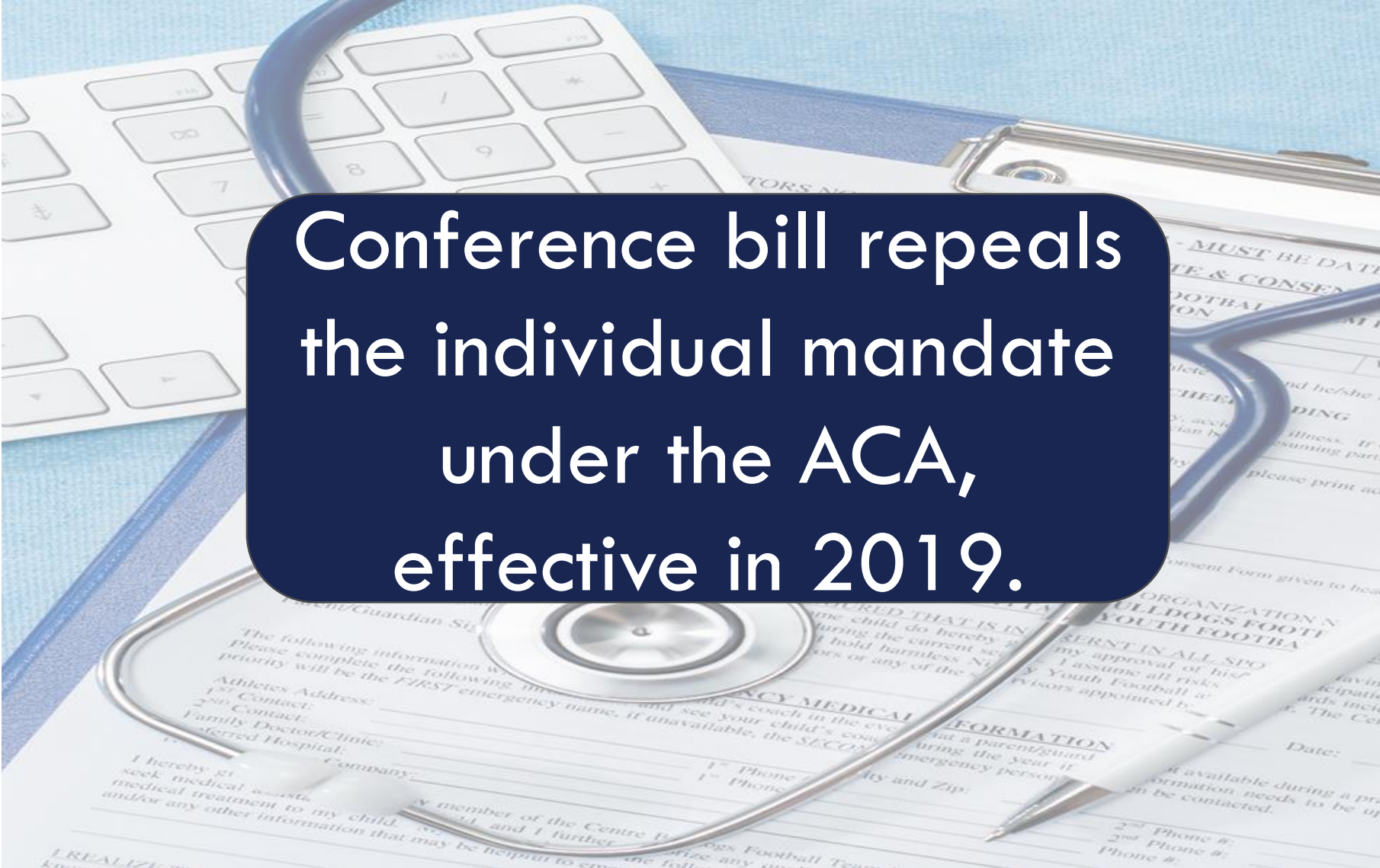
Conference bill
limits deduction for
NOLS arising after
2017 to 80% of
taxable income in
the carryforward
years.

BUSINESS LOSS LIMITS

Conference bill restricts current use of “excess business losses” of individuals to \$250,000 (\$500,000 on joint returns) starting in 2018.



INDIVIDUAL MANDATE REPEALED



Conference bill repeals
the individual mandate
under the ACA,
effective in 2019.

CREDITS

- Conference agreement repeals rehabilitation credit for pre-1936 buildings, but retains 20% credit for certified historic structures, subject to transition rules.
- Rejects House passed provisions phasing out the Work Opportunity Tax Credit and the New Markets Tax Credit.
- While the research credit is retained, research expenditures paid or incurred after 2021 will be amortized rather than deducted currently.
- House proposals to reform the American Opportunity Tax Credit and repeal the Lifetime Learning Credit are rejected in the conference agreement.

OTHER ITEMS IN TAX REFORM

Moving expense deduction

Repealed after 2017 except for members of armed forces.

Back Door Roth IRA repeal

“Back door” Roth IRA contributions repealed after 2017.

Teacher expense deduction

Unchanged!

STATE AND LOCAL INCOME TAXES

- Significant revenue and compliance implications for states.
- Conformity to Federal rules?
 - Bonus depreciation.
 - Net operating losses.
 - Interest limitation.
- Watch state legislative changes to decouple from, or conform to, Federal rules
- Reduced Federal corporate rate increases effective impact of state and local income taxes.

QUESTIONS?

This presentation is presented with the understanding that the information contained does not constitute legal, accounting or other professional advice. It is not intended to be responsive to any individual situation or concerns, as the contents of this presentation are intended for general information purposes only. Viewers are urged not to act upon the information contained in this presentation without first consulting competent legal, accounting or other professional advice regarding implications of a particular factual situation. Questions and additional information can be submitted to your Eide Bailly representative, or to the presenter of this session.

THANK YOU

Insert contact information



CPAs & BUSINESS ADVISORS



CPAs & BUSINESS ADVISORS