

Tax Cuts and Jobs Act:

Your Guide to Success

Have you heard?

Federal tax reform is happening through the **Tax Cuts and Jobs Act**. One of the initial goals of the tax legislation was simplification of the tax code. While this bill does simplify things for many middle to lower income Americans, primarily through the increase of the standard deductions and child credits, this bill does not represent significant tax simplification for everyone else. It does, however, represent the most sweeping change to the Tax Code since 1986.

Given the size and complexity of the tax bill, this summary only highlights a few selected items, including planning items that individuals and businesses should consider during the course of the coming year. Unless otherwise noted, the bill is effective for years beginning after December 31, 2017 (so, 2018 for calendar-year filers).

The Tax Cuts and Jobs Act creates many gray areas subject to interpretation without the existence of additional regulations. You can find further clarifications as they are released throughout 2018 at www.deandorton.com/taxcutsandjobsact.

Learn more about how you may be affected:

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Individual Tax Rates

Under the new tax law, the individual income tax brackets are structured as follows:

Tax Rate	Single	Married Filing Jointly
10%	\$0 – \$9,525	\$0 – \$19,050
12%	\$9,526 – \$38,700	\$19,051 – \$77,400
22%	\$38,701 – \$82,500	\$77,401 – \$165,000
25%	\$82,501 – \$157,500	\$165,001 – \$315,000
32%	\$157,501 – \$200,000	\$315,001 – \$400,000
35%	\$200,001 – \$500,000	\$400,001 – \$600,000
37%	\$500,001+	\$600,001+



Personal Exemptions and Standard Deduction

The personal exemptions are eliminated and the standard deductions increased to \$12,000 single and \$24,000 married filing jointly (MFJ), indexed for inflation for tax years beginning after 2018.

State, Local, and Property Taxes

For tax years beginning after December 31, 2017 and before January 1, 2026, the combined deduction for property taxes and state and local income taxes is limited to \$10,000 MFJ. Sales taxes may be included as an alternative to claiming state and local income taxes.

Mortgage and Home Equity Line Interest

For home acquisition indebtedness incurred before December 15, 2017, the limitation remains at \$1,000,000. Home acquisition debt incurred after this date is subject to a \$750,000 limitation. The law eliminates the deduction for home equity line interest deductions.

Medical Expenses

For tax years beginning after December 31, 2016 and ending before January 1, 2019, the threshold for deduction is reduced to 7.5% of AGI. However, this adjustment is only temporary, as the threshold for deduction will return to 10% of AGI for tax years beginning after December 31, 2018.

Charitable Contributions for Purchase of Seating to College and University Athletic Events

For tax years beginning after December 31, 2017, taxpayers are no longer able to take a charitable deduction for any portion of contribution made to an athletic event for an educational organization.

Expanded Use of Section 529 Account Funds

For distributions after December 31, 2017, "qualified higher education expenses" include tuition at an elementary or secondary public, private, or religious school, and various expenses associated with home school, up to a \$10,000 limit per tax year.

Individual Alternative Minimum Tax (AMT)

For tax years beginning after December 31, 2017 and ending before January 1, 2026, the AMT exemption amounts are \$70,300 for single filers and \$109,400 MFJ. Additionally, the exemption phase-out amounts are \$500,000 for single filers and \$1,000,000 MFJ.

Estate and Gift Tax

The estate and gift tax basic exclusion amount is doubled from \$5,000,000 to \$10,000,000, indexed for inflation. The generation skipping transfer (GST) exemption amount is also increased to \$10,000,000, indexed for inflation. These changes are effective for decedents dying and for gifts made after December 31, 2017 and before January 1, 2026. The bill does not provide for a repeal of the estate or GST tax in the future.

Alimony

Deductions and inclusion are repealed under the new law for divorce or separation instruments executed after December 31, 2018.

Other Items of Interest

- Personal exemptions are suspended
- Miscellaneous itemized deductions are suspended
- Itemized deduction limitation is suspended
- Casualty and theft losses are suspended

Corporate Tax Rates

Income Tax Rate		
Old Law	New Law*	Taxable Income Levels
15%	21%	\$0 – \$50,000
25%	21%	\$50,001 – \$75,000
34%	21%	\$75,001 – \$100,000
39%	21%	\$100,001 – \$335,000
34%	21%	\$335,001 – \$10,000,000
35%	21%	\$10,000,001 – \$15,000,000
38%	21%	\$15,000,001 – \$18,333,333
35%	21%	\$18,333,334

*Personal Service Corporations (PSCs) receive no special tax rate.

Pass-Through Entities

Generally, for tax years beginning after December 31, 2017 and before January 1, 2026, individual taxpayers with domestic “qualified business income” from sole proprietorships, partnerships, and S corporations would be allowed a new deduction of up to 20% this income. Qualified business income is defined as income other than investment income (e.g., dividends, interest income, capital gains, etc.). The deduction could not exceed the greater of:

1. **50%** of the taxpayer’s allocable portion of W-2 wages paid, or
2. The sum of **25%** of the taxpayer’s allocated W-2 wages plus **2.5%** of the taxpayer’s allocated unadjusted basis, immediately after acquisition of all “qualified property.”

This second limitation would allow businesses to be eligible for the deduction based on owning property that qualified under the provision, with or without applicable wages.

Qualified property: tangible, depreciable property which is held by and available for use in the qualified trade or business at the close of the tax year, which is used at any point during the tax year in the production of qualified business income, and the depreciable period for which has not ended before the close of the tax year

However, the W-2 wage limit does not apply in the case of a taxpayer with taxable income not exceeding \$315,000 for MFJ (\$157,500 other individuals). The application of the W-2 wage limit is phased in for individuals with taxable income exceeding these thresholds over the next \$100,000 of taxable income for MFJ (\$50,000 for other individuals).

The deduction generally does not apply to specified service businesses, unless the taxpayer’s income is below the applicable thresholds stated above.

Corporate Alternative Minimum Tax

The corporate AMT is repealed for tax years beginning after 2017. In addition, for years beginning after 2017 and before 2022, the AMT credit is refundable and can offset regular tax liability in an amount equal to 50% (100% for tax years beginning in 2021) of the excess of the minimum tax credit for the tax year over the amount of the credit allowable for the year against regular tax liability. Accordingly, the full amount of the minimum tax credit will be allowed in tax years beginning before 2022.

Depreciation

Bonus Depreciation: 100% of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023 can be expensed. Beginning with 2023, bonus depreciation will be phased out at a rate of 20% each year until fully phased out after 2027. Additionally, the requirement that the original use of property commence with the taxpayer has been removed. As such, the definition of qualified property is effectively expanded to include used property.

Section 179 Deduction: The maximum amount that may be expensed under this provision is \$1,000,000. Additionally, the phase-out threshold for the deduction is \$2,500,000. Beginning with property acquired after December 31, 2018, both the maximum deduction and phase-out amount will be indexed for inflation.

Farm Property: Machinery and equipment used in farming operations have a useful life of five years, and are now depreciated using the 200% declining balance method.

Business Interest Deduction Limitations

For tax years beginning after December 31, 2017, every business, regardless of its form, is generally subject to a disallowance of a deduction for net interest expense in excess of 30% of the business’s “adjusted taxable income.” The net interest expense disallowance is determined at the taxpayer level. However, a special rule applies to pass-through entities such as S corporations or partnerships, which require the determination to be made at the entity level.

For tax years beginning after December 31, 2017 and before January 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion, and without the former domestic production deduction (which is repealed effective December 31, 2017). An exemption rule applies for taxpayers with average annual gross receipts of less than \$25,000,000 for the prior three-year period.

Contact us to learn how your business can take advantage of exemption strategies, R&D tax credits, and more:
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Employer Credit for Paid Family and Medical Leave

For tax years beginning after December 31, 2017, an employer that offers at least two weeks of annual paid family and medical leave, as described by the Family and Medical Leave Act (FMLA), to all “qualifying” full-time employees (proportionate for non-full-time employees) is entitled to a tax credit. The paid leave must provide for at least 50% of the wages normally paid to the employee. “Family and medical leave” does not include leave provided as vacation, personal leave, or other medical or sick leave.

The credit is equal to 12.5% of the amount of wages paid to a qualifying employee during such employee’s leave, increased by 0.25% for each percentage point that the employee’s rate of pay on leave exceeds 50% of the wages normally paid to the employee (but not to exceed 25% of the wages paid).

Rollover of Plan Loan Offset Amounts

For tax years beginning after December 31, 2017, the period to roll over a loan offset is extended to the individual’s due date for the tax return for the year in which the offset occurred (including extensions).

Tip: Review your company’s retirement plan loan distribution paperwork and determine whether any prospective modifications need to be made.

Moving/Relocation Expenses

For tax years beginning after December 31, 2017, qualified moving expense reimbursements are no longer excluded from wages, except for Armed Forces on active duty, and are no longer deductible by the employee.

Tip: Review your company policies relating to moving/relocation expenses and adjust them accordingly. Any reimbursements of these expenses to employees or direct payments of moving expenses on behalf of employees (e.g., payments directly to a moving company) should be treated as taxable compensation to the employee going forward.

Employee Achievement Awards

For expenses beginning January 1, 2018, the employee’s exclusion and employer’s deduction for employee achievement awards do not apply to cash and so-called “cash equivalents” (e.g., gift coupons/certificates, vacations, meals, lodging, tickets to sporting or theater events, securities, and other similar items). However, an employee can still exclude (and an employer can still deduct) the value of other tangible property and gift certificates that allow the recipient to select tangible property from a limited range of items pre-selected by the employer. The prior law annual amounts still apply.

Tip: Review your company policies relating to employee achievement awards. If your company chooses to continue providing cash or cash equivalents, these should be treated as taxable compensation to the employee going forward. Alternatively, you can adjust your company policy to provide only non-cash/cash equivalents achievement awards going forward.

Employer’s Deduction for Entertainment, Commuting Benefits, and Meals

For expenses beginning January 1, 2018, all entertainment, amusement, recreation expense, membership dues for business, recreation and social clubs, and related facility expenses are 100% disallowed, regardless of whether or not they are directly related to the active conduct of a trade or business. However, the 50% deduction for food and beverages associated with the active conduct of a trade or business is retained.

The employer deduction for qualified transportation fringe benefits is fully disallowed. In addition, except as necessary for ensuring the safety of an employee, the employer deduction for providing transportation or any payment or reimbursement for commuting to work is disallowed.

There is a 50% limitation on the deduction for food and beverages that qualify as a de minimis fringe benefit, including expenses for the operation of an employee cafeteria located on or near the employer’s premises.

Tip: Segregate these expenses in your accounting system so they can be appropriately treated under the new law. You should consider your company policy related to these expenses and assess whether prospective changes need to be made.

There are a few employment-related changes in the new tax bill which could require companies to rework internal policies or accounting immediately in 2018.



In addition to the business provisions noted earlier, there are a few items of particular interest to the real estate industry.

The increased bonus depreciation, 100% (full expensing) for qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023, could make the current benefits of cost segregation studies even more beneficial. Cost segregation studies break out the components of a property that would normally be classified with a 39-year life into shorter life categories. The new bonus depreciation can enhance the benefits of these component reclassifications.

The limitation on the deduction of interest expense discussed above would appear to have a major negative impact on real estate businesses at first glance. However, taxpayers who have gross receipts under \$25,000,000 are exempt from the limitation. Real estate businesses that otherwise would have to apply this limitation can elect out of the limitation by using the alternative depreciation system (ADS), rather than the modified accelerated cost recovery system (MACRS). ADS lives are longer than MACRS lives (although the residential real estate life has been reduced to 30 years), and assets using ADS lives are not qualified for the 100% bonus depreciation or Section 179 expensing. As such, if the business interest limitation applies to a taxpayer, they need to consider the financing terms and interest expense relative to net income, as well as the implications of cost recovery/expensing of assets, and the QBI deduction.

Before the Tax Cuts and Jobs Act, there were three types of qualified improvements to real property: qualified leasehold improvements, qualified restaurant improvements, and qualified retail improvements. All three definitions varied and had different implications for the ability to currently expense improvements. The new law provides for a single **qualified improvement property**. This property is any improvement to the interior portion of a building placed in service after the original building is placed in service, and is effective for assets placed in service after December 31, 2017. Qualified improvement property has a **15-year** recovery period (20-year ADS period), which means it is eligible for the 100% bonus depreciation from January 1, 2018 through December 31, 2022, as well as Section 179 expensing.

Like-Kind Exchanges

Previously, taxpayers could elect to defer gains on the sale of assets used in a trade or business by making a qualified like-kind exchange (LKE) and following specific guidelines issued by the IRS. After December 31, 2017, LKEs are limited to real property not held primarily for sale, and tangible personal property no longer qualifies. While this seems like great news for those in real estate, it may add levels of complexity related to transactions in which there were previous cost segregations that pulled out tangible personal property from the purchase or construction of a building. Buyers and sellers may consider allocation of purchase price to interior items more closely, as it is possible there may be assets included in the sale that do not qualify for a like-kind exchange.

Rehabilitation Credit

Under prior law, there was a 20% credit for qualified expenses to certified historic structures or structures in certified historic district, and a 10% credit for expenses related to a qualified rehabilitated building, subject to specific rules and reporting requirements. Under the Tax Cuts and Jobs Act, for amounts paid and incurred after December 31, 2017, the 10% credit is repealed, and the 20% credit is only eligible for certified historic structures. There is a transition rule for buildings that were owned prior to January 1, 2018 that may have qualified under the old law.

Qualified Opportunity Fund Deferral of Income

A new gain deferral was created by the new Act. Effective December 22, 2017, there is a temporary deferral from inclusion in income for gains that are reinvested in a "Qualified Opportunity Fund" (QOF), and a **permanent** exclusion of gains on the sale of an investment in a QOF.

Qualified opportunity fund: an investment created for the purpose of investing in qualified opportunity zone property and at least 90% of the assets in the fund is qualified opportunity zone property

The Tax Cuts and Jobs Act designates certain low-income community population census tracts as qualified opportunity zones. Once designated, it remains in effect until the end of the tenth calendar year beginning on or after designation. A list of the census tract zones is located at www.huduser.gov/portal/sadda/sadda_qct.html.



Owners who conduct horse operations as a business will benefit from the federal depreciation provisions noted earlier. Of particular significance is the expansion of the definition of “new” for the 100% bonus depreciation to include qualifying assets not previously owned by the purchaser that were acquired and placed in service after September 27, 2017. Breeding stock (e.g., mares and stallions) may now qualify, in addition to other common equine assets such as racing prospects, equipment, fencing, land improvements, and barns. Those who made qualifying purchases during 2017 should consider whether or not 2017 depreciation should be maximized; the election out of the 100% bonus depreciation is also available.

Beginning in 2018, new farm equipment qualifies as five-year property, while used farm equipment remains as seven-year property. The ability to use 200% declining balance versus 150% declining balance will also accelerate depreciation deductions for those in the horse business. And, while not included with federal tax reform, the extenders bill that was passed in February reinstates the three-year recovery period for yearlings through December 31, 2017.

Like-kind exchanges of horses, vehicles, and farm equipment are no longer eligible for tax-free treatment for years beginning after 2017 (2018 calendar year for most filers).

Additionally, some horse owners may be affected beginning in 2018 by a provision that limits the overall active business losses incurred by non-corporate taxpayers. This primarily affects owners who generate net business losses that offset non-business income (like investment income). If the 2018 net business loss is in excess of \$250,000 for single filers (\$500,000 MFJ), the excess is converted into a net operating loss carryover to 2019 subject to the 80% limitation.

For example, if I am a single taxpayer and my active business losses (from all businesses) are \$300,000, I may include the \$250,000 of business loss on my 2018 federal tax return but the remaining \$50,000 loss becomes a net operating loss carryover into 2019. This may be a one-year or multiple-year deferral of the \$50,000 2018 excess loss, depending on my activity in future years.

Horse owners may want to consider 2017 depreciation choices in light of this provision, which may reduce or eliminate the ability to fully recognize the 100% bonus depreciation for 2018 purchases.

Since many horse owners conduct equine operations via flow-through entities, there may be a potential to qualify for the 20% qualified business deduction. However, as noted above, there may be limitations that apply. Given this deduction and the reduced C corporation tax rates, it is wise to evaluate the current structure for your horse.



There are several provisions related to the Tax Cuts and Jobs Act that may impact tax-exempt organizations. Below are just a few highlights.

For tax years beginning after December 31, 2017, tax-exempt organizations are required to calculate unrelated business taxable income (UBTI) separately for each trade or business carried on, in effect prohibiting deductions relating to one business from offsetting income derived from another business. This could be a big deal for exempt organizations that have been using losses from one activity to offset income from another. Importantly, net operating losses from prior years will continue to be available to offset net income, regardless of the source of the loss.

The new Act requires tax-exempt organizations to increase UBTI by the amount of certain fringe benefits, such as qualified transportation and on-premise athletic facilities, provided to their employees, effective for amounts paid or incurred after December 31, 2017.

The new Act repeals the exclusion from gross income for interest on a bond issued to advance refund another bond for bonds issued after December 31, 2017. It also repeals the authority to issue tax credit bonds and direct-pay bonds issued after December 31, 2017.

Private activity bonds, which were on the chopping block in the House version of the bill, remain intact—for now. There is continuing discussion in Congress on returning private activity bonds to the purposes for which they were originally intended.

For tax years beginning after December 31, 2017, a 1.4% excise tax is imposed on net investment income on private colleges and universities (and their related organizations) that:

1. Have at least 500 students;
2. Have at least 50% of their students located within the United States; and
3. Have assets (other than assets used directly in carrying out the institution's educational purpose) with an aggregate fair market value of at least \$500,000 per full-time student at the end of the preceding year.

The assets and net investment income of related organizations are to be included in determining the applicability and amount of the tax if the assets and income are available to the educational institution. Harvard has estimated that, had this provision been in place last year, its tax bill would have been \$43,000,000.

For tax years beginning after 2017, an excise tax of 21% is imposed on compensation, plus any parachute payment in excess of \$1,000,000, paid to any of a tax-exempt organization's five highest compensated employees for the year and any employee who was one of the organization's five highest paid employees in any tax year beginning after 2016. The tax applies to W-2 wages, not including designated Roth contributions, but including amounts included under Section 457(f). In addition, payments to medical professionals for providing medical or veterinary services are exempt from the definition of "compensation" for purposes of the tax. This provision applies to both public and private organizations and includes compensation from any related or governmental entity. So, paying a senior executive or coach \$6,000,000 will cost the organization an additional \$1,050,000.

While the itemized deduction for charitable donations was not repealed, the Act does disallow certain other itemized deductions and increases the standard deduction for individuals, thus removing the benefit of a charitable deduction for many. A 2017 study by the Indiana University Lilly Family School of Philanthropy suggests that charitable giving may drop by up to \$13 billion annually. For fundraisers, we're suggesting focusing more on the good you do and less on deductibility, at least for smaller donors.

Keep in mind that, while the increased standard deduction and lowering of itemized deductions is expected to result in only 5% of taxpayers itemizing deductions, before the change only about 30% of taxpayers itemized. So even before this change, 70% of taxpayers received no benefit from charitable contributions and yet, many contributed anyway.

Don't see your industry listed?

Check us out online to learn more.

deandorton.com/taxcutsandjobsact Louisville 502.589.6050 Lexington 859.255.2341

Disclaimer: The information presented is not intended to be a full and exhaustive explanation of the tax bills referenced. Please consult your tax advisor regarding the policies that might be applicable to your specific situation.

