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TAX REFORM

On December 22, 2017, President Trump signed into law the most important rewrite of the US tax code in decades. The federal law, which is entitled "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution of the budget for the fiscal year 2018" (the Act), has no other name, as its short title, the Tax Cuts and Jobs Act, was stricken from the bill shortly before being signed. As the Act is now law, we want to provide you with a general summary of how the Act may affect you, including a non-exhaustive list of some of its key changes.

Individual Federal Income Tax Changes. Without further legislation, the Act's individual provisions generally apply to tax years after December 31, 2017, and sunset after December 31, 2025, unless otherwise stated below.

- *Individual Income Tax Rates*. The Act retains the seven federal income tax brackets, but the income tax rates for some brackets have been reduced, including a reduction of the highest marginal tax rate from 39.6 percent to 37 percent. Long-term capital gain and qualified dividend rates remain unchanged.
- *Standard Deduction and Personal Exemption*. The standard deduction has almost doubled, but the deduction for personal exemptions has been suspended.
- *Itemized Deductions*. For those who will continue to itemize their income tax deductions despite the higher standard deduction, there have been several modifications:
  - *Pease Limitation*. Taxpayers with income exceeding $261,500 for single filers ($313,800 for married couples filing jointly) no longer have to reduce certain itemized deductions by 3 percent of each dollar that exceeds the above thresholds, up to 80 percent (i.e., a suspension of the Pease Limitation).
  - *Home Mortgage Interest*. While current homeowners' mortgages are not affected, taxpayers who purchase a home in the future may only deduct interest on up to $750,000 (formerly $1,000,000) of acquisition debt on a principal residence and a second residence. The deduction for interest on any home equity line of credit (HELOC) is also suspended. (Homeowners can still exclude up to $500,000 of gain on the sale of a principal residence

if they lived in them for two of the five years prior to the sale of the residence.)

    - *Miscellaneous Itemized Deductions*. All miscellaneous itemized deductions subject to the 2 percent floor, such as expenses for the production or collection of income and tax preparation expenses, are suspended.
    - *State and Local Taxes*. Itemized deductions for state and local property taxes and sales or income taxes are now limited to $10,000 for married couples filing jointly (formerly an unlimited amount).
    - *Medical Expenses*. Medical expenses are deductible if they exceed 7.5 percent of a taxpayer's adjusted gross income (AGI) (formerly 10 percent of AGI), but only for the 2017 and 2018 tax years. After 2018, the 10 percent floor is reinstated.
    - *Charitable Contributions*. The charitable deduction remains in place with an upward adjustment on the limitation for cash gifts (from 50 percent of AGI to 60 percent). Charitable deductions for payments made in exchange for college athletic event seating rights are suspended.
- *529 Plans*. 529 Plans are permanently expanded to provide for tax-free distributions of up to $10,000 per beneficiary per tax year for qualifying K-12 education expenses (previously limited to qualifying higher education expenses).
- *Like-Kind Exchanges*. Non-recognition of gain for like-kind exchanges is now permanently limited to only real property not held primarily for sale.
- *Affordable Care Act*. The Act permanently eliminates (starting in 2019) the individual mandate that penalizes individuals without a health care plan.

Federal Estate, Gift, and Generation-Skipping Transfer Tax Changes. For decedents or individuals making gifts after December 31, 2017, and before January 1, 2026, the Act increases the federal estate, gift, and generation-skipping transfer (GST) tax exemption equivalent from $5 million to $10 million and indexes it for inflation from 2011 (with 2018 expected to be $11.2 million after being indexed for inflation). This could have a drastic impact on estate plans with formulaic devises linked to the exemptions.

The concept known as "portability," wherein a married person's unused exemption at his or her death may be used by his or her surviving spouse, remains intact. The marginal tax rate for estate, gift, and GST also remains at 40 percent.

Business Entity Tax Changes. Without further legislation, the Act's business provisions permanently apply to tax years beginning after December 31, 2017, unless otherwise stated below.

- *Corporate Tax Rate***.** The graduated corporate tax brackets (and the top marginal corporate tax rate of 35 percent) have been replaced with a 21 percent flat rate. In addition, the corporate alternative minimum tax (AMT) is repealed. In anticipation of S-corporations terminating their status and converting to C-corporations to take advantage of the new reduced corporate tax rate, the Act also provides special rules for such a conversion.
- *Pass-Through "Qualified Business Income" Deduction*. A new "qualified business income" deduction is now allowed for pass-through entities (such as partnerships, limited liability companies, and S-corporations) equal to 20 percent of such qualified business income, subject to several limitations and phase-outs. This deduction is scheduled to end after 2025.
- *Business Asset Expensing*. The Act allows 100 percent expensing for certain "qualified property," subject to phase-outs beginning after December 31, 2022. This means taxpayers can deduct the full cost of qualified property in the year it was placed in service rather than capitalize the expense and deduct the cost of the property over several years.
- *Cash Method of Accounting*. The Act allows C-corporations and certain partnerships to utilize the cash method of accounting if they have average annual gross receipts of $25 million or less (formerly only available to entities with $5 million or less).
- *Interest Deductions*. Business interest deductions are now generally limited to 30 percent of adjusted taxable income plus business interest income. These limitations generally apply to businesses with annual gross receipts of more than $25 million.
- *Other Business Deductions and Credits*. The Act attempts to broaden the tax base for businesses by eliminating several business deductions such as the domestic production activities deduction, deductions for entertainment expenses, and deductions for providing certain transportation benefits to employees. In addition, certain research and experimental expenditures previously deductible must now be capitalized and amortized over a five-year period. This provision applies to expenditures paid or incurred after December 31, 2021.
- *Net Operating Losses*. The Act limits a net operating loss (NOL) deduction to 80 percent of taxable income in each year. In addition, NOLs can no longer be carried back to prior taxable years but may be carried forward indefinitely.

International Business Tax Changes. The Act permanently switches the United States from a worldwide tax system to a territorial tax system and makes the following modifications beginning after December 31, 2017, unless otherwise stated below.

- *Dividends from Foreign Subsidiaries*. The Act now allows certain domestic corporations to take a 100 percent deduction for the foreign-sourced portion of the dividends received from certain foreign corporations (known as a "participation exemption regime"), meaning corporations generally will not owe taxes on income derived offshore.
- *Deemed Repatriation*. In connection with transitioning to a participation exemption regime, the Act generally requires US shareholders to pay a one-time tax on the existing, previously untaxed deferred foreign income of certain foreign corporations. Taxpayers may elect to pay this tax over eight years. This provision is effective for the last taxable year of a foreign corporation that begins before January 1, 2018, regarding US shareholders.
- *Anti-Base Erosion and Profit Shifting Measures*. The Act imposes a new "base erosion minimum tax" on certain amounts paid by US businesses to foreign related parties to prevent businesses from stripping earnings out of the United States by making payments to foreign affiliates that may be deducted for US tax purposes. The rule applies to US corporations with average annual gross receipts of at least $500 million.

As we continue to analyze the Act and its impact on our clients, we will provide frequent updates and recommend planning strategies on our Business & Tax Blog (blog.williamsparker.com/businessandtax/). To better understand how the Act may affect you, we encourage you to meet with your tax advisor and attorney. For specific questions regarding this letter, please contact us at (941) 893-4010 or taxreform@williamsparker.com.

On behalf of everyone at Williams Parker, I hope you and your family have a healthy and happy New Year.

Regards,

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