Happy New Year Tax Changes!

December 26, 2017

Most of the new tax bill (the "Tax Cut and Jobs Act of 2017") is pretty straightforward.

All of the tax rates are lowered for individuals and corporate rates are reduced from 34% (for income between $75,000 and $10,000,000) to a flat 21%. This is, obviously, a huge reduction; but there are other nice changes to the old law (Tax Reform Act of 1986).

I won't bore you with a lot of esoteric law changes; but just give you a heads-up on the major changes that will affect most practices and their owners.

I promise to give you a more detailed analysis when the Treasury Department releases regulations on this new statute.

State and Local Taxes (SALT): there has been a lot of talk about this issue in the press; but most of the conversation was hyperbolic. Under the new law the personal deduction for SALT is limited to $10,000; but the business deduction remains; subject to some limitations discussed below.

Home Mortgage and Home Equity Loan Interest: Under old law, the taxpayer could deduct, as an itemized deduction, qualified residence interest, which included interest paid on a mortgage secured by a principal residence or a second residence. The underlying mortgage loans could represent acquisition indebtedness of up to $1 million ($500,000 in the case of a married individual filing a separate return), plus home equity indebtedness of up to $100,000.

Under the new law the deduction for interest on home equity indebtedness is eliminated and the deduction for mortgage interest is limited to underlying indebtedness of up to $750,000 ($375,000 for married taxpayers filing separately).

Charitable Contributions: Deductions for cash contributions to public charities and certain private foundations is increased to 60% from 50%. Contributions exceeding the 60% limitation are allowed to be carried forward and deducted for up to five years.

Alimony Expense/Income: Alimony has always been a deductible expense to the payor and income to the payee. This rule will be suspended for any divorce settled after 12/31/18.

Miscellaneous Expenses: Under the old law, taxpayers were allowed to deduct certain miscellaneous itemized deductions to the extent that they exceeded 2% of the taxpayer's adjusted gross income. The new law eliminates this provision.

Obamacare Individual Mandate: As I am sure all of you have heard, the tax penalty imposed on families that do not purchase health insurance has been repealed.

Estate Tax: there was considerable discussion about eliminating the estate tax entirely; but, due to the Byzantine rules of reconciliation, it was not possible. However, the exemption for estates *was* doubled from $5 million to $10 million.

Alternative Minimum Tax: The alternative minimum tax (AMT) is a tax system separate from the regular tax. It is intended to prevent a taxpayer with substantial income from avoiding tax liability by using various exclusions, deductions, and credits. AMT rates are applied to income determined after the taxpayer "gives back" an assortment of tax benefits. If the tax determined under these calculations exceeds the regular tax, the larger amount is owed.

In computing the AMT, only alternative minimum taxable income (AMTI), above an AMT exemption amount, is taken into account. The AMT exemption amount is set by statute and adjusted annually for inflation, and the exemption amounts are phased out at higher income levels.

Under the old law, for 2018, the exemption amounts were scheduled to be:

- $86,200 for marrieds filing jointly/surviving spouses;
- $55,400 for other unmarried individuals;
- 50% of the marrieds-filing-jointly amount for marrieds filing separately, i.e., $43,100;

And, those exemption amounts were reduced by an amount equal to 25% of the amount by which the individual's AMTI exceeded certain thresholds. Under the new law the AMT exemption amounts for individuals are as follows:

- For joint returns and surviving spouses, $109,400.
- For single taxpayers, $70,300.
- For marrieds filing separately, $54,700;

Under the new law, the above exemption amounts are reduced (not below zero) to an amount equal to 25% of the amount by which the AMTI of the taxpayer exceeds the phase-out amounts, increased as follows:

- For joint returns and surviving spouses, $1 million.
- For all other taxpayers (other than estates and trusts), $500,000.

Section 529 Accounts: Under the old law, funds in a Section 529 College Savings Account could only be used for "qualified higher education expenses". If funds were withdrawn from the account for other purposes, each withdrawal was treated as containing a pro-rata portion of earnings and principal. The earnings portion of a nonqualified withdrawal was taxable as ordinary income and subject to a 10% additional tax unless an exception applied.

“Qualified higher education expenses” included tuition, fees, books, supplies, and required equipment, as well as reasonable room and board if the student was enrolled at least half-time. Eligible schools included colleges, universities, vocational schools, or other postsecondary schools eligible to participate in a student aid program of the Department of Education. This included nearly all accredited public, nonprofit, and proprietary (for-profit) postsecondary institutions.

Under the new law, distributions after Dec. 31, 2017, “qualified higher education expenses” include tuition at an elementary or secondary public, private, or religious school.

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

Section 179 Expensing: As we have discussed in prior articles a taxpayer may elect under Section 179 to deduct (or “expense”) the cost of “qualifying property”, rather than to recover such costs through depreciation deductions. Under the old law, the maximum amount a taxpayer could expense was $500,000 of the cost of qualifying property placed in service for the tax year. The $500,000 amount was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the tax year exceeds $2 million. These amounts were indexed for inflation.

In general, “qualifying property” is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business, and includes off-the-shelf computer software and qualified real property (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

Under the new law, the maximum amount a taxpayer may expense under Section 179 is increased to $1 million, and the phase-out threshold amount is increased to $2.5 million. For tax years beginning after 2018, these amounts are indexed for inflation.

The definition of “qualified real property” eligible for Section 179 expensing is also expanded to include the following improvements to nonresidential real property after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems. This is a rather significant change for professional businesses and codifies the changes in Regulations that I have been arguing for for years.

Bonus Depreciation: Under the old law, an additional first-year depreciation deduction was allowed equal to 50% of the adjusted basis of qualified property, the original use of which began with the taxpayer and placed in service before Jan. 1, 2020. Under the new law a 100% first-year deduction for the adjusted basis is allowed for qualified property acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023. The additional first-year depreciation deduction is allowed for new and used property.

Like-Kind Exchanges: Under the old law, the like-kind exchange rule provided that no gain or loss was recognized to the extent that property-which included a wide range of property from real estate to tangible personal property-held for productive use in the taxpayer’s trade or business, or property held for investment purposes, is exchanged for property of a like-kind that also is held for productive use in a trade or business or for investment.

Under the new law the rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges only with respect to real property *that is not held primarily for sale*. However, under a transition rule, the pre-Act like-kind exchange rules apply to exchanges of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before Dec. 31, 2017.

Employer's Deduction for Fringe Benefit Expenses: Under the old law, a taxpayer may deduct up to 50% of expenses relating to meals and entertainment. Housing and meals provided for the convenience of the employer on the business premises of the employer are excluded from the employee's gross income. Various other fringe benefits provided by employers are not included in an employee's gross income, such as qualified transportation fringe benefits. Under the new law deductions for entertainment expenses are disallowed, eliminating the subjective determination of whether such expenses are sufficiently business related; the current 50% limit on the deductibility of business meals is expanded to meals provided through an in-house cafeteria or otherwise on the premises of the employer.

Conclusion: This isn't an exhaustive list of the new changes in the Code; but it is a nice summary and I wanted you to have it as we go into the New Year.

We hope that you and your family had a wonderful Christmas and will have a very prosperous New Year.