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Federal Tax Alert

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Federal Tax Reform; H. R. 1-Tax Cuts and Jobs Act

The following is a summary of some of the significant changes of federal tax law made by the enactment of H.R. 1, originally named and referred to as the Tax Cuts and Jobs Act, which was signed by the President on December 22, 2017. This summary is an overview highlighting some of the important changes in federal taxes made by the Act, to generally be effective in 2018.

Tax Reform for Individuals	Prior Law 2017	Tax Cuts and Jobs Act 2018	Results/Effects
Maximum individual income tax rate	39.6%, for income over \$470,700, married/joint, and over \$418,400, single	37%, for income over \$600,000 married/joint, and over \$500,000, single	Individual taxpayers will be taxed at lower federal income tax rates on their income beginning in 2018.
Income Tax Rate Structure	Graduated rate structure, <i>e.g.</i> for Married Individuals Filing Joint Returns: 10% of taxable income 15% of excess over \$18,650 25% of excess over \$75,900 28% of excess over \$153,100 33% of excess over \$233,350 35% of excess over \$416,700 39.6 % of excess over \$470,700	Reduced graduated rate structure, <i>e.g.</i> for Married Individuals Filing Joint Returns: 10% of taxable income 12% of excess over \$19,050 22% of excess over \$77,400 24% of excess over \$165,000 32% of excess over \$315,000 35% of excess over \$400,000 37 % of excess over \$600,000 This rate structure does not apply to taxable years after December 31, 2025.	Greater amounts of individual taxable income will be taxed under a lower set of graduated rate brackets. Tax savings should generally be enjoyed by many individuals under the Act beginning in 2018, as compared to the higher individual tax rate structure under present law. Example: House and Senate Conference Committee published report states the typical family of four earning the median family income of \$73,000 will receive a tax cut of \$2,059.
Pass-Through Entity Owner Tax Deduction	39.6% maximum income tax rate, and lower individual graduated rates, apply to income passed through to individuals who are partners or owners of partnerships, LLCs, S corporations or sole	An individual taxpayer generally may deduct 20% of qualified business income passed through to the taxpayer as owner of a partnership, LLC, S corporation, or sole proprietorship. The deduction is	The Act will provide an additional 20% tax deduction in determining federal income tax for owners of partnerships, limited liability companies (LLCs), S corporations, and

	proprietorships that are not subject to tax at entity level.	subject to specified limitations. The deduction is effective for taxable years beginning after December 31, 2017; and shall not apply to taxable years beginning after December 31, 2025.	sole proprietorships. The change and its effects should be carefully considered by businesses organized and operating in these forms.
Capital Gains	Net long-term capital gains and qualified dividends are generally taxed at a 15% rate; a 20% rate applies for capital gain of a taxpayer that would otherwise be taxed at a 39.6% income tax rate; and 0% for income that would be taxed in 10% and 15% brackets. Long-term gain arises from sale of capital assets held for more than one (1) year.	Present law maximum rates on net capital gains and qualified dividends are generally retained.	Individual taxpayers should generally not have a change from current law as to taxation of capital gains, except for change in application of cost-of-living increases that will be indexed differently.
Standard Deduction	\$12,700, Married/Joint Return \$6,350, Married filing separate \$9,350 Head of household \$6,350 Single The standard deduction is claimed instead of itemized deductions; and is indexed (increased) annually for inflation.	The standard deduction is increased to: \$24,000, Married/Joint Return \$12,000, Married filing separate \$18,000 Head of household \$12,000 Single The increased standard deduction is effective for taxable years beginning after December 31, 2017; and does not apply for taxable years beginning after December 31, 2025.	The new law allows a significantly increased standard deduction for individual taxpayers. The change is expected to simplify tax return preparation and filing for more taxpayers by providing a much higher standard deduction, thereby avoiding time, complexity and expense that can be involved in separately itemizing deductions.
Personal, Dependent Exemption	An exemption of \$4,050 is allowed for a taxpayer, the taxpayer's spouse and any dependents of the taxpayer. The exemption is phased out and not allowed for higher income taxpayers.	The personal, dependent exemption deduction is "suspended" and not allowed for tax years 2018 through 2025.	Eliminates the individual deduction for personal and dependent exemptions allowed under present law. The change may unfavorably affect taxpayers who can claim a number of personal and dependent exemptions under present law.
Home Mortgage Interest Deduction	Mortgage interest is deductible by individuals for acquisition and home equity indebtedness, applicable to the taxpayer's principal residence and one other residence. An individual may not deduct interest on acquisition indebtedness exceeding \$1,000,000, for Married/Joint Return	Interest is deductible by individuals for home acquisition indebtedness. An individual may not deduct interest on acquisition indebtedness exceeding \$750,000, for Married/Joint. Effective in tax years 2018 through 2025.	Reduces tax deduction for home mortgages for individual taxpayers with higher amounts of mortgage indebtedness. For taxpayers with presently existing home acquisition mortgages the present law limits should continue to apply.

Charitable Deduction	Charitable contributions made by an individual are deductible. The deduction is limited to 50% of the taxpayer's contribution base (generally, the taxpayer's adjusted gross income).	The income based percentage limit is increased from 50% to 60% of the taxpayer's contribution base. The Act changes requirements for substantiation of charitable contributions.	The new law is described as continuing and expanding the itemized deduction for charitable contributions by individuals.
State and Local Tax Deduction	Individuals may deduct state and local property and income taxes paid. A taxpayer may elect to deduct state and local sales taxes paid in lieu of deducting state and local income taxes.	State and local taxes deduction by individuals shall be limited to \$10,000 married filing joint, other taxpayers; \$5,000 for married filing separate return; in taxable years 2018 through 2025.	The law reduces the federal income tax deduction for state and local taxes, such as property taxes, income taxes (or sales taxes) up to an aggregate amount of \$10,000 married filing joint, other taxpayers; \$5,000 for married filing separate return.
Medical Expense Deduction	Medical expenses (not covered by insurance) are generally deductible to extent exceeding 10% of adjusted gross income.	The threshold for deducting medical expenses shall be 7.5% of adjusted gross income for all taxpayers for tax years 2017 and 2018.	Temporarily increases availability and amount of deduction for qualifying unreimbursed out-of-pocket medical expenses incurred by an individual.
Overall Limitation of Deductions	Itemized deductions are phased out and not allowed for upper-income individuals (adjusted gross income exceeding \$313,800, married/joint, \$261,500, single)	The overall limitation on itemized deductions is suspended effective taxable years beginning after December 31, 2017, through December 31, 2025.	Individual taxpayers with higher income will not be subject to a "phase-out" denial of otherwise allowable itemized deductions for a tax year.
Miscellaneous itemized deductions	Miscellaneous individual itemized deductions are deductible only to extent they exceed 2% of the taxpayer's adjusted gross income.	All miscellaneous itemized deductions subject to the 2% floor are suspended for taxable years beginning after December 31, 2017, through December 31, 2025.	Miscellaneous itemized deductions, which include unreimbursed employee expenses, and certain other expenses, are to be suspended and may not be claimed as individual deductions in tax years beginning after December 31, 2017, through December 31, 2025.
Exclusion of Gain from Sale of Residence	Exclusion of gain from the sale of an individual's residence is allowed for \$500,000 for Married/Joint and \$250,000 other filers, allowed if the taxpayer has owned/used the home as principal residence for 2 of the 5 years before sale.	The conference report of Congress on the Act states that the conference agreement contains no provision on modification of the exclusion of gain from sale a residence.	The present law exclusion of gain from sale of a residence will continue to apply.
Child Credit	\$1,000 credit is allowed for each qualifying child under age 17, phased out for taxpayers with higher income.	The child tax credit is temporarily increased to \$2,000 per qualifying child. The maximum amount refundable may not exceed \$1,400 per	The new law expands the child tax credit to \$2,000 for parents, and provides for a fully refundable credit up to \$1,400, providing a

		qualifying child. Effective for tax years 2018 through 2025.	more generous tax break for lower income taxpayers.
Alimony	Alimony or separate maintenance payments are deductible in determining adjusted gross income of the individual paying such payments the year paid.	Alimony and separate maintenance payments shall not be deductible by the spouse making payment. Effective for divorce instruments executed after December 31, 2018.	The deduction for alimony and separate maintenance payments made pursuant to a divorce will no longer be deductible for federal income tax purposes. Payments made under divorce instruments made before December 31, 2018, and not subsequently changed, will be deductible to the extent provided under present law.
Individual Alternative Minimum Tax	Income must be computed for regular income tax and alternative minimum tax (AMT) liability, and the greater amount must be paid. AMT income includes more income and allows fewer deductions. An exemption amount is provided, of \$84,500 for married filing joint, and \$54,300, single, which is phased out and not allowed for higher income taxpayers.	The individual AMT exemption amount and phase out thresholds are increased for taxable years after December 31, 2017, and beginning before January 1, 2026. The individual AMT is not repealed.	The changes enacted are described as reducing federal income tax complexity and tax burdens for millions of individual taxpayers affected by the AMT.
Cost of Living Adjustments	Many amounts and items under the federal tax law are adjusted for inflation (e.g. individual standard deduction). Most adjustments are based on annual changes of the Consumer Price Index for All Urban Consumers (CPI-U).	Adjustments will be based on the Chained Consumer Price Index for All Urban Consumers (C-CPI-U); effective for taxable years beginning after December 31, 2017.	The Chained Consumer Price Index, or C-CPI-U, has been described as an index that grows at a slower pace than the CPI-U used under present law.
Business Tax Reform	Prior Law 2017	Tax Cuts and Jobs Act 2018	Results/Effects
Top Corporate Tax Rate	The top corporate federal income tax rate is a 35% maximum rate determined under a graduated rate structure. Personal service corporations taxed at flat 35% rate.	The corporate graduated tax rate structure shall be eliminated, and instead corporate taxable income shall be taxed at a 21% rate. A special rate for personal service corporations is not provided. Applicable to taxable years beginning after December 31, 2017.	The significantly lower corporate tax rate is intended to provide corporate tax saving allowing corporate earnings to be available for new investment and jobs creation.
Cost Recovery, Expensing of Investment	Additional first-year 50% "bonus depreciation" is deductible in the year of	The additional first-year "bonus depreciation is to be generally increased to 100% for property	Similarly, the significantly greater bonus depreciation is intended to encourage

	placing certain qualified property (depreciable tangible personal property) in service.	placed in service before January 1, 2023. The deduction percentage is phased down in subsequent years. It is allowed for new and used property.	and enable businesses to add new investment and create jobs.
Interest Deduction	Interest paid or accrued by a business is generally deductible under present law, subject to limitations.	The amount of deductible business interest is to be limited to the sum of business interest income, 30% of adjusted taxable income, and floor plan financing of the taxpayer for the taxable year. Disallowed interest deductions may be carried forward indefinitely, subject to exceptions. Special rules are to apply to partnerships. Under an exception, the limitation on deduction of interest does not apply to a business with average annual gross receipts not exceeding \$25 million. Applicable to taxable years beginning after December 31, 2017.	The new law necessitates consideration of the limitation on deductibility of interest and the exceptions provided in business planning of financing decisions and transactions involving required interest payments.
Small Business Section 179 Expensing	Businesses may immediately expense up to \$500,000 of cost of “section 179 property” placed in service each year, consisting of tangible personal property subject to phase out if investment in a taxable year exceeds \$2,000,000, adjusted for inflation.	The amount a taxpayer may expense under section 179 is increased to \$1,000,000; and the phase-out threshold is increased to \$2,500,000. These amounts are indexed for inflation.	The new increased limit is intended to encourage qualifying business investments.
Domestic Production Activities	Taxpayers may claim a deduction of a specified percentage of the lesser of the taxpayer’s “qualified production activities income” derived from activities in the U.S., or taxable income, subject to limitation.	The deduction for income attributable to domestic production activities is repealed, generally effective for taxable years beginning after December 31, 2017, and effective for C corporations for taxable years beginning after December 31, 2018.	Repeal of this deduction must be considered by business taxpayers that would otherwise have qualified for it under present law.
Corporate Alternative Minimum Tax	Income must be computed for regular income tax and alternative minimum tax (AMT) liability, and the greater amount must be paid. AMT income represents a broader scope of income, and certain deductions are not allowed.	The corporate alternative minimum tax (AMT) is repealed, effective for taxable years beginning after December 31, 2017.	Repeal of the corporation AMT is intended to simplify and reduce corporate income taxes.
Like-Kind Property Tax Free Exchanges	The exchange of like-kind property used in business or	The non-recognition of gain in the case of like-kind property exchanges shall be limited to	The modified allowance of a tax-free exchange of like-kind property should be

	held for investment purposes is not taxable.	real property that is not held primarily for sale. Applicable to exchanges completed after December 31, 2017.	considered in evaluating transfers of property that may have been able to be exchanged tax-free under present law rules.
Net Operating Loss (NOL) Deduction Carryback and Carryforward	A net operating loss (NOL), which is amount current-year deductions exceed gross income, may be carried back two (2) years and carried forward twenty (20) years, to offset taxable income in those years.	The NOL deduction is limited to 80% of taxable income, for taxable years beginning after December 31, 2017. The two (2) year carryback of NOL is generally repealed.	NOL tax benefits will be affected and limited as described after 2017.
Entertainment, etc. expenses	Deduction of entertainment expense is not allowed except that expenses for entertainment and expense for food and beverage is allowed if directly related to active conduct of the taxpayer's trade or business, and is associated with a substantial and bona fide business discussion; 50% of expenses may be deducted.	The Act repeals the present law exception to the deduction disallowance for entertainment that is directly related (or in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50% limit to such deductions). Deduction of 50% of food and beverage associated with operating a trade or business generally is retained. Applicable to amounts paid or incurred after December 31, 2017.	The modification of the rules on disallowance of deduction of entertainment expenses will need to be taken into account by businesses that incur such expenses beginning in 2018.
Contributions to Capital	Gross income of a corporation does not include contributions to capital; and a corporation does not recognize gain or loss on receipt of money or property in exchange for stock of the corporation.	"Contributions to capital" shall not include any contribution in aid of construction or any other contribution as a customer or potential customer, and any contribution by any governmental entity or civic group (other than a contribution by a shareholder as such). Applicable to contributions made after the date of enactment of the Act.	All transactions that may have qualified for exclusion of contributions to capital under present law rules must be reconsidered and evaluated.
Tax Accounting	Businesses are generally not allowed to use the cash method of accounting except for businesses with gross receipts of less than \$5 Million. Businesses must account for inventories and use an overall accrual	The exceptions from specified general accounting rules for businesses with lesser stated amounts or gross receipts are modified. The applicable limits are increased to \$25 Million. Generally effective for taxable	More flexible and less rigid tax accounting rules are provided to a greater number of businesses.

	method, except for businesses with gross receipts under \$10 Million. Uniform capitalization rules require businesses to capitalize certain costs, except for businesses with gross receipts under \$10 Million.	years beginning after December 31, 2017.	
Federal Estate and Gift Tax Reform	Prior Law 2017	Tax Cuts and Jobs Act 2018 -2025	Results/Effects
Estate Tax	Federal estate tax at maximum rate of 40% applies to the taxable estate of a decedent.	The present law is not changed.	The federal estate tax law has not been repealed as had been advocated in many proposals for federal tax reform. However, the significant increase in the federal estate tax exemption under the Act suggests a thorough review of all existing estate plans and estate planning documents, should be made, and planning and documents be modified to most advantageously take into account the much higher exemption amount.
Estate and Gift Tax Exemption	A unified gift and estate tax credit equivalent exemption of \$5,000,000, is allowed, indexed for inflation and increased to \$5,490,000 in 2017, and \$5,600,000 in 2018.	The gift and estate tax exemption will be doubled to \$10,000,000 for transfers made after December 31, 2017, and before January 1, 2026. The increased exemption, indexed for inflation, would be \$11,200,000 in 2018.	The doubling of the estate tax exemption will effectively avoid estate tax liability for many more individuals and their estates. Estate plans and documents previously completed based upon a much lower federal estate tax exemption allowed under prior law should be reviewed and modifications made if appropriate to avoid unintended and unnecessary complexity and costs of administering an estate and trusts created by a decedent.
Repeal of Estate Tax	The federal estate tax is not subject to repeal at any date under present law.	The federal estate tax is not repealed.	As, indicated, the estate tax continues to be in effect, although its application will be more limited. It should be noted that the increased exemption amount is not permanent, and applies only through 2025, necessitating

			continuing analysis of individual estate plans.
Gift Tax	Federal gift tax at maximum rate of 40% applies to lifetime taxable gifts transferred to other persons.	The present law is not changed.	The federal gift tax will continue to apply, and the increased exemption should be considered in life-time gifting plans and strategies.
Generation-skipping transfer tax	Taxable generation-skipping transfers subject a GST tax at flat rate of 40%. An exemption equal to the estate and gift tax exemption is allowed.	The present law is not changed.	The increased estate tax exemption is understood to also apply to transfers subject to the generation-skipping transfer tax.
Stepped-up basis of property included in a decedent's estate	The tax basis of property inherited from a decedent for purposes of determining gain on sale of the property subject to federal income tax is generally the fair market value (FMV) of the property on the date of the decedent's death.	The present law is not changed.	The continued allowance of stepped-up basis for property included in a decedent's estate should be carefully considered in light of the change in the federal estate tax exemption. Transfers made under estate plans and documents previously signed based upon a lower estate tax exemption may limit the favorable effect of the stepped-up basis rule.
International Tax Reform	Prior Law 2017	Tax Cuts and Jobs Act 2018	Results/Effects
Foreign Source Income	Domestic businesses are generally taxed on all income worldwide. However, foreign income earned by a foreign subsidiary of a U. S. corporation generally is not subject to U. S. tax until income is distributed as a dividend to the U. S. corporation	A modified territorial tax structure would be implemented for foreign earnings of U. S. businesses.	Taxpayers with foreign operations and income must consider these significant changes.
Dividend Exemption	Not applicable under present law	100% of foreign-source portion of dividends paid by a foreign corporation to and received by a U. S. corporate shareholder that owns 10% or more of the foreign corporation would be excluded.	The new rule for foreign source dividends exclusion must also be considered by all taxpayers with foreign operations and activities.
Transition Rule / Repatriated Earnings	Not applicable under present law	U. S. shareholders of a specified foreign corporation generally would include in income for 2017, the shareholder's pro rata share of accumulated post-1986 deferred foreign income of the corporation to the extent it has	The transition rule for taxation of previously sheltered foreign earnings must be considered and acted upon by taxpayers affected by the rule.

		not been subject to U. S. income tax. A portion of the pro-rata amount would be deductible. When deemed repatriated and subject to U. S. income tax the deferred income of the corporation would be taxed at a reduced rate, with a rate method used to result in a 15.5% rate of tax on the accumulated foreign earnings held in the form of cash or cash equivalents, and an 8% rate of tax on all other earnings. The increased tax liability on the repatriated foreign corporation income may be paid over an eight (8) year period.	
Foreign Tax Credit	A credit for foreign income tax paid by a corporation in and to another country is allowed against any U. S. tax owed on that income by the corporation.	A foreign tax credit would not be allowed as to foreign income for which a dividend exclusion is allowed.	Taxpayers that will be allowed the foreign source dividends exclusion must take this change into account.

The Tax Cuts and Jobs Act contains numerous other changes that could be very significant to a particular individual and business taxpayer. A detailed review of the new law and all of the changes enacted by it is recommended.

If you have questions or would like to discuss the new federal tax law, how it may affect you, or particular individual, business and estate planning issues and situations, please contact any attorney of GableGotwals you know or the firm's Tax Law Practice Group.

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