Patrick B. Mason
pat@mzlawyers.net

William L. Zoccola
will@mzlawyers.net

MASON ZOCCOLA LAW FIRM, PLLC

First, we listen.

The recently enacted Tax Cuts and Jobs Act (TCJA) is a sweeping tax package. Here's a look at some of the more important elements of the new law that have an impact on individuals and businesses. Unless otherwise noted, the changes are effective for tax years beginning in 2018 through 2025.

Individuals

- *Tax rates.* The new law imposes a new tax rate structure with seven tax brackets: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top rate was reduced from 39.6% to 37% and applies to taxable income above $500,000 for single taxpayers and $600,000 for married couples filing jointly. The rates applicable to net capital gains and qualified dividends were not changed. The "kiddie tax" rules were simplified. The net unearned income of a child subject to the rules will be taxed at the capital gain and ordinary income rates that apply to trusts and estates. Thus, the child's tax is unaffected by the parent's tax situation or the unearned income of any siblings.

- *Standard deduction.* The new law increases the standard deduction to $24,000 for joint filers, $18,000 for heads of household, and $12,000 for singles and married taxpayers filing separately. Given these increases, many taxpayers will no longer be itemizing deductions. These figures will be indexed for inflation after 2018.

- *Exemptions.* The new law suspends the deduction for personal exemptions. Thus, starting in 2018, taxpayers can no longer claim personal or dependency exemptions. The rules for withholding income tax on wages will be adjusted to reflect this change.

- *New deduction for "qualified business income."* Starting in 2018, taxpayers are allowed a deduction equal to 20 percent of "qualified business income," otherwise known as "pass-through" income, i.e., income from partnerships, S corporations, LLCs, and sole proprietorships. The income must be from a trade or business within the U.S. Investment income does not qualify, nor do amounts received from an S corporation as reasonable compensation or from a partnership as a guaranteed payment for services provided to the trade or business. The deduction is not used in computing adjusted gross income, just taxable income. For taxpayers with taxable income above $157,500 ($315,000 for joint filers), (1) a limitation based on W-2 wages paid by the business and depreciable tangible personal property used in the business is phased in, and (2) income from the following trades or businesses is phased out of qualified business income: health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners.

- *Child and family tax credit.* The new law increases the credit for qualifying children (i.e., children under 17) to $2,000 from $1,000, and increases to $1,400 the refundable portion of the credit. It also introduces a new (nonrefundable) $500 credit for a taxpayer's dependents who are not qualifying children. The adjusted gross income level at which the credits begin to be phased out has been increased to $200,000 ($400,000 for joint filers).

- *State and local taxes.* The itemized deduction for state and local income and property taxes is limited to a total of $10,000 starting in 2018.

- *Mortgage interest.* Under the new law, mortgage interest on loans used to acquire a principal residence and a second home is only deductible on debt up to $750,000 (down from $1 million), starting with loans taken out in 2018. There is no longer any deduction for interest on home equity loans, regardless of when the debt was incurred.

- *Miscellaneous itemized deductions.* There is no longer a deduction for miscellaneous itemized deductions which were formerly deductible to the extent they exceeded 2 percent of adjusted gross income. This category included items such as tax preparation costs, investment expenses, union dues, and unreimbursed employee expenses.

- *Medical expenses.* Under the new law, for 2017 and 2018, medical expenses are deductible to the extent they exceed 7.5 percent of adjusted gross income for all taxpayers. Previously, the AGI "floor" was 10% for most taxpayers.

- *Casualty and theft losses.* The itemized deduction for casualty and theft losses has been suspended except for losses incurred in a federally declared disaster.

- *Overall limitation on itemized deductions.* The new law suspends the overall limitation on itemized deductions that formerly applied to taxpayers whose adjusted gross income exceeded specified thresholds.

- *Moving expenses.* The deduction for job-related moving expenses has been eliminated, except for certain military personnel. The exclusion for moving expense reimbursements has also been suspended.

- *Alimony.* For post-2018 divorce decrees and separation agreements, alimony will not be deductible by the paying spouse and will not be taxable to the receiving spouse.

- *Health care "individual mandate."* Starting in 2019, there is no longer a penalty for individuals who fail to obtain minimum essential health coverage.

- *Estate and gift tax exemption.* Effective for decedents dying, and gifts made, in 2018, the estate and gift tax exemption has been increased to roughly $11.2 million ($22.4 million for married couples).

- *Alternative minimum tax (AMT) exemption.* The AMT has been retained for individuals by the new law but the exemption has been increased to $109,400 for joint filers ($54,700 for married taxpayers filing separately), and $70,300 for unmarried taxpayers. The exemption is phased out for taxpayers with alternative minimum taxable income over $1 million for joint filers, and over $500,000 for all others.

Businesses

- *Corporate tax rates reduced.* One of the more significant new law provisions cuts the corporate tax rate to a flat 21%.

- *Dividends-received deduction.* The dividends-received deduction available to corporations that receive dividends from other corporations has been reduced under the new law. For corporations owning at least 20% of the dividend-paying company, the dividends-received deduction has been reduced from 80% to 65% of the dividends. For corporations owning under 20%, the deduction is reduced from 70% to 50%.

- *Alternative minimum tax repealed for corporations.* The corporate alternative minimum tax (AMT) has been repealed by the new law.

- *Alternative minimum tax credit.* Corporations are allowed to offset their regular tax liability by the AMT credit. For tax years beginning after 2017 and before 2022, the credit is refundable in an amount equal to 50% (100% for years beginning in 2021) of the excess of the AMT credit for the year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the credit will be allowed in tax years beginning before 2022.

- *Net Operating Loss ("NOL") deduction modified.* Under the new law, generally, NOLs arising in tax years ending after 2017 can only be carried forward, not back. The general two-year carryback rule and other special carryback provisions have been repealed. However, a two-year carryback for certain farming losses is allowed. These NOLs can be carried forward indefinitely, rather than expiring after 20 years. Additionally, under the new law, for losses arising in tax years beginning after 2017, the NOL deduction is limited to 80% of taxable income, determined without regard to the deduction. Carryovers to other years are adjusted to take account of the 80% limitation.

- *Limit on business interest deduction.* Under the new law, every business, regardless of its form, is limited to a deduction for business interest equal to 30% of its adjusted taxable income. For pass-through entities such as partnerships and S corporations, the determination is made at the entity, i.e., partnership or S corporation, level. Any business interest disallowed under this rule is carried into the following year, and, generally, may be carried forward indefinitely. The limitation does not apply to taxpayers (other than tax shelters) with average annual gross receipts of $25 million or less for the three-year period ending with the prior tax year.

- *Domestic production activities deduction ("DPAD") repealed.* The new law repeals the DPAD for tax years beginning after 2017.

- *New fringe benefit rules.* The new law eliminates the 50% deduction for business-related entertainment expenses.

- *Sexual harassment.* Under the new law, effective for amounts paid or incurred after December 22, 2017, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if the payments are subject to a nondisclosure agreement.

- *Lobbying expenses.* The new law disallows deductions for lobbying expenses paid or incurred after the date of enactment with respect to lobbying expenses related to legislation before local governmental bodies (including Indian tribal governments). Under pre-Act law, such expenses were deductible.

- *Family and medical leave credit.* A new general business credit is available for tax years beginning in 2018 and 2019 for eligible employers equal to 12.5% of wages they pay to qualifying employees on family and medical leave if the rate of payment is 50% of wages normally paid to the employee. The credit increases by 0.25% (up to a maximum of 25%) for each percent by which the payment rate exceeds 50% of normal wages.

- *Qualified rehabilitation credit.* The new law repeals the 10% credit for qualified rehabilitation expenditures for a building that was first placed in service before 1936, and modifies the 20% credit for qualified rehabilitation expenditures for certified historic structure.

- *Increased Code Sec. 179 expensing.* The new law increases the maximum amount that may by expensed under Code Sec. 179 to $1 million. If more than $2.5 million of property is placed in service during the year, the $1 million limitation is reduced by the excess over $2.5 million.

- *Bonus depreciation.* Under the new law, a 100% first-year deduction is allowed for qualified new and used property acquired and placed in service after September 27, 2017 and before 2023.

- *Depreciation of qualified improvement property.* The new law provides that qualified improvement property is depreciable using a 15-year recovery period and the straight-line method.

- *Depreciation of farming equipment and machinery.* Under the new law, subject to certain exceptions, the cost recovery period for farming equipment and machinery the original use of which begins with the taxpayer is reduced from 7 to 5 years.

- *Luxury auto depreciation limits.* Under the new law, for a passenger automobile for which bonus depreciation (see above) is not claimed, the maximum depreciation allowance is increased to $10,000 for the year it's placed in service, $16,000 for the second year, $9,000 for the third year, and $5,760 for the fourth and later years in the recovery period.

- *Computers and peripheral equipment.* The new law removes computers and peripheral equipment from the definition of listed property. Thus, the heightened substantiation requirements and possibly slower cost recovery for listed property no longer apply.