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TAX UPDATE:
17 Fundamental Changes in the Tax Cuts and Jobs Act

INSTRUCTOR NAMES: DAVID CHASE | CHRISTINE C. HINES
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TIME: 3:00PM
LOCATION: VIRGINIA BEACH CENTRAL LIBRARY

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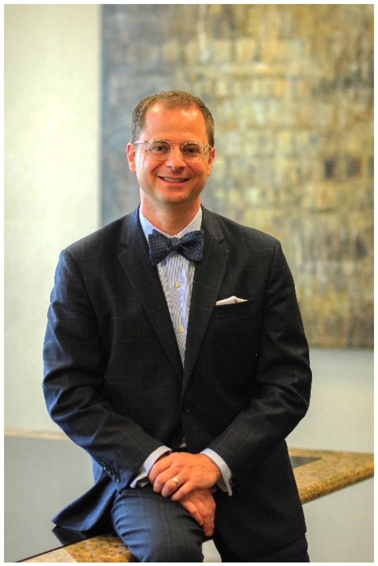
ABOUT THIS COURSE

- **Course Description:**
  Tax reform update. Discussions will include highlights of most provisions of the Tax Act with in-depth analysis.
- **Prerequisites and Advanced Preparation Required:**
  None
- **Level of Course:**
  Basic
- **Method of Delivery:**
  Group-Live

ABOUT THE PRESENTERS



David M. Chase, CPA
Shareholder

David joined the firm in 2004 and focuses his practice on tax and business matters. He works with high net-worth families and their related closely-held businesses through all phases of the business cycle, including planning, growth and exit, and advises on the tax ramifications on complex business transactions.

He collaborates closely with firm and outside legal counsel on structuring issues, transactional matters and estate planning. He has substantial experience with partnership taxation matters particularly relevant to growth, joint venture and real estate clients.

Education
Old Dominion University
Bachelor of Science in Business Administration with concentrations in accounting and IT
Magna Cum Laude

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Christine C. Hines, CPA

Tax Supervisor

Christine joined the firm in 2014 and provides tax compliance services for clients across a variety of industries, including real estate, manufacturing and wholesale distribution.

Focusing on tax and business matters, Christine works with high net-worth families and their related closely-held businesses through all phases of the business cycle. She has experience performing investigative analysis for litigation support projects and also enjoys tax research for transactional and other special projects.

Education
Virginia Tech
Bachelor of Science with a concentration in Finance

Old Dominion University
Masters of Science in Accounting

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Tax Cuts and Jobs Act

Legislative Timeline

November 2, 2017 Bill introduced in the House of Representatives

November 16, 2017 The House passed the bill with a 227-205 vote

December 2, 2017 The Senate passed their version of the bill with a 51-49 vote

December 15, 2017 Conference Committee signed the final version that reconciled differences between the House and Senate bills

December 20, 2017 Senate and the House passed the final version

December 22, 2017 Bill was signed into law by the president titled "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," commonly referred to as the Tax Cuts and Jobs Act ("TCJA")

Tax Cuts and Jobs Act

Tax Legislation

- Proposed Regulations – Notice of Proposed Rulemaking (NPRM) provide guidance concerning Treasury's interpretation of a Code section. The public is given an opportunity to comment and public hearings may occur.

- Temporary Regulations – Provide guidance for the public and IRS employees with respect to procedural and computational maters.

- Final Regulations – Supersede both temporary and proposed regulations. Effective the day that it is published as a Treasury Decision in the Federal Register, unless otherwise stated.

Taxpayers may rely on the regulations until superseded regulations are issued.

Tax Cuts and Jobs Act

Proposed Regulations

• July 18, 2018	REG-103474-18 Tax Return Preparer Due Diligence
• August 8, 2018	REG-104397-18 Additional First Year Depreciation Deduction
• August 9, 2018	REG-104226-18 Transition Tax Under Section 965
• August 16,2018	REG-107892-18 Qualified Business Income Deduction 199A
• August 27, 2018	REG-112176-18 Contributions in Exchange for State or Local Tax Credits
• September 14, 2018	REG-104390-18 Global Intangible Low-Taxed Income (GILTI Tax)
• October 19, 2018	REG-115420-18 Investing in Qualified Opportunity Zones

AGENDA

17 Fundamental Changes:

1. Individual Taxes, Rates, etc.
2. Personal Deductions, Exclusions, and Credits
3. Loss Provisions
4. Deferred Compensation and Tax-Preferred Accounts
5. Ordinary Income / Capital Gains Treatment
6. Estate and Gift Tax Provisions
7. Disaster Relief Provisions
8. IRS Practice and Procedure
9. Retirement Plan Provisions
10. Corporate Taxes, Rates, etc.
11. Expensing, Depreciation, and Capitalization
12. Business Deductions, Exclusions, and Credits
13. Accounting Methods
14. Pass-Through Entities
15. Tax-Exempt Organizations and Bonds
16. ESBT Provisions
17. Foreign and International Tax Provisions

17 FUNDAMENTAL CHANGES

1. Individual Taxes, Rates, etc.

- Seven tax brackets (previously six); new brackets for capital gain and AMT; new filing thresholds

17 FUNDAMENTAL CHANGES

1. Individual Taxes, Rates, etc.

New Minimum Filing Thresholds

Single individual	$12,000
Single individual, 65 or older or blind	13,600
Single individual, 65 or older and blind	15,200
Married individual, separate return	12,000
Married couple, joint return	24,000
Married couple, joint return, one spouse 65 or older or blind	25,300
Married couple, joint return, one spouse 65 or older and blind	26,600
Married couple, joint return, both spouses 65 or older or blind	26,600
Married couple, joint return, both spouses 65 or older and blind	29,200
Head of household	18,000
Head of household, 65 or older or blind	19,600
Head of household, 65 or older and blind	21,200
Qualifying widow(er) (surviving spouse)	24,000
Qualifying widow(er) (surviving spouse), 65 or older or blind	25,300
Qualifying widow(er) (surviving spouse), 65 or older and blind	26,600

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17 FUNDAMENTAL CHANGES

1. Individual Taxes, Rates, etc.

- Top tax bracket reduced from 39.6% to 37%
- Standard deduction increased (MFJ: $24,000; HH: $18,000; S: $12,000)
- Personal exemptions suspended
- Kiddie Tax rate on unearned income is now based on rates for trusts and estates rather than parents' rates
- Affordable Care Act individual health insurance mandate repealed
- Qualified dividends and capital gains rates remain the same
- Additional Medicare tax remains at .9%; 3.8% on net investment income

17 FUNDAMENTAL CHANGES

2. Personal Deductions, Exclusions, and Credits

- IRC §164(b)(6) State and Local Tax (SALT) deduction limited to $10,000

PERSONAL ASSETS

For tax years 2018 through 2025, an individual may claim an itemized deduction on Schedule A of up to $10,000 ($5,000 for married taxpayer filing a separate return) for:

- state and local real property taxes;
- state and local personal property taxes; and
- state and local income taxes, as well as state and local sales taxes deducted in lieu of state and local income taxes.

BUSINESS ASSETS

State and local property taxes are fully deductible in computing an individual's Schedule C, Schedule E, or Schedule F of Form 1040.

EXAMPLE

Julia owns a residential rental property and may deduct the property taxes she pays for that property because it is an income-producing or business asset.

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17 FUNDAMENTAL CHANGES

2. Personal Deductions, Exclusions, and Credits

IRC §163(h)(3) Qualified Residence Interest

- Mortgage interest expense deduction limited to $750,000 acquisition debt
- No deduction for home equity line of credit

Mortgage interest allowed to be deducted is not limited, however, it lowers the limit on the amount of acquisition indebtedness from which the interest is derived, from $1 million to $750,000 ($375,000 for single and married-but-filing-separate taxpayers).

- Only affects taxpayers who acquire a new mortgage after December 15, 2017 and before January 1, 2026.
- Current homeowners are allowed to keep their previous limitation of $1 million ($500,000 for single/separate filers).

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17 FUNDAMENTAL CHANGES

2. Personal Deductions, Exclusions, and Credits

- Mortgage interest expense deduction limited to $750,000 acquisition debt

EXAMPLE

In 2018, George's mortgage balance on his principal residence is $1.5 million for the entire year, and he incurs interest of $75,000. The mortgage is grandfathered and the applicable balance limit on the mortgage loan deduction is $1 million.

$$\frac{\$1{,}000{,}000 \text{ limit}}{\$1{,}500{,}000 \text{ balance}} \times \$75{,}000 \text{ interest} = \$50{,}000 \text{ deduction}$$

The deduction on Schedule A for mortgage interest will be $50,000, and the remaining $25,000 ($75,000 minus $50,000) represents excess interest, which is nondeductible on Schedule A. If George has a home office, additional limitations may apply.

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17 FUNDAMENTAL CHANGES

2. Personal Deductions, Exclusions, and Credits

- Medical deduction threshold temporarily reduced to 7.5% for 2017 and 2018 only
- Cash charitable contributions limitation increased to 60% of adjusted gross income (AGI); no change for non-cash limitations
- Child Tax Credit increased to $2,000 and phase-out levels increased
- Discharged student loan debt excluded from income under death or disability
- Pease limitation suspended

17 FUNDAMENTAL CHANGES

2. Personal Deductions, Exclusions, and Credits

Phase-Out or Overall Limitation on Itemized Deductions Suspended (Pease Limitation)

For 2018, the phase-out or overall limitation on itemized deductions is temporarily **repealed** through 2025.

For tax years prior to 2018 and after 2025, the Pease limitation will apply.

For 2017, the AGI thresholds are:

- $313,800 for married individuals filing jointly or surviving spouses;
- $287,650 for heads of households;
- $261,500 for unmarried individuals filing as single; and
- $156,900 for married individuals filing separately.

Generally, the Pease limitation is the lesser of 3% of AGI or 80% of certain allowable deductions.

Full explanation of the limitation has been intentionally omitted due to temporary repeal.

17 FUNDAMENTAL CHANGES

2. Personal Deductions, Exclusions, and Credits

Significant Repealed Provisions

- SALT payments greater than $10,000 are nondeductible
- No deduction for home equity line of credit (HELOC)
- No deduction for college athletic seating rights
- No deduction for new alimony

The **deduction** of qualified alimony and separate maintenance payments by a **payor** and the inclusion of the payments in gross **income** by the **payee** are repealed.

This repeal is only effective for any divorce or separation instruments executed or modified after 2018.

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17 FUNDAMENTAL CHANGES

2. Personal Deductions, Exclusions, and Credits

Significant Repealed Provisions

- No deduction for miscellaneous itemized deductions subject to 2% of AGI limitation
- Bicycling commuting reimbursement now taxable
- Moving reimbursement now taxable, unless for military order
- No deduction for moving expenses, unless for military order

17 FUNDAMENTAL CHANGES

3. Loss Provisions

- IRC §461 Limitation on "excess business loss"

The taxpayer's aggregate deductions for the tax year from their trades or businesses — { **The taxpayer's aggregate gross income or gain for the tax year from such trades or businesses** + **$250,000, adjusted annually for inflation** (200% of the $250,000 amount in the case of a joint return) }

EXAMPLE 1

For 2018, Ned Brown has $1 million of gross income and $1.4 million of deductions from a retail business that is not a passive activity. His excess business loss is $150,000.

($1,400,000 – ($1,000,000 + $250,000))

Ned must treat his excess business loss of $150,000 as an NOL carryover to 2019.

17 FUNDAMENTAL CHANGES

3. Loss Provisions

- New limitation on "excess business loss"

This provision limits the ability of non-corporate taxpayers to use trade or business losses against other sources of income, such as wages and other compensation (see the next slide for example), fees, interest, dividends and capital gains.

The practical result is that the business losses of a non-corporate taxpayer for a tax year can offset no more than $500,000 (for married individuals filing jointly), or $250,000 (for other individuals), of a taxpayer's non-business income for that year.

Note that if married taxpayers file a joint return, the losses (up to the $500,000 limit) of one spouse can also be used to offset the other spouse's non-business income.

Non-corporate taxpayers must apply the passive activity loss rules before application of the rules for excess business losses.

17 FUNDAMENTAL CHANGES

3. Loss Provisions

- New limitation on “excess business loss”

EXAMPLE 2

In 2017, X and Y quit their jobs in order to start a business, as equal partners. X is single and invests $500,000 of capital, and so does Y, who is married. The 2018 partnership tax return reports a net loss of $700,000. X's and Y's allocable share of the partnership's loss is $350,000 each, which they report on Schedule E of their respective 2018 individual tax returns.

In 2018, X received a salary of $300,000 before forming the partnership and had income from other sources of $50,000. Even though X has an excess business loss, X can use $250,000 (up to the threshold amount) of the losses from the partnership to offset X's other income. However, even though X has sufficient income in 2018 to offset the entire loss, X must treat the $100,000 excess business loss as an NOL carryforward. If the partnership is not profitable in 2018 and X has no other substantial sources of income, X must continue to carry forward the NOL.

17 FUNDAMENTAL CHANGES

3. Loss Provisions

- No deduction for personal or casualty losses, **except** in a federally-declared disaster
- Gambling loss limitation modified to included all wagering expenses, not just gambling losses

EXAMPLE

Expenses incurred in traveling to and from a casino fall within the scope of the gambling loss limitation, and these expenses may only be deducted to the extent of gambling winnings.

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17 FUNDAMENTAL CHANGES

4. Deferred Compensation and Tax-Preferred Accounts

- New deferral election for qualified equity grants

Non-executive employees who are granted stock options are able to elect to defer recognition of income for up to five years. This is intended to help cash shortage of employees receiving equity grant.

The corporation must maintain a written plan under which at least 80% of all employees providing services to the corporation are granted stock options with the same rights and privileges.

This election, Code Sec. 83(i), is an alternative to being taxed in the year in which the property vests under Code Sec. 83(a) or in the year it is received under Code Sec. 83(b).

17 FUNDAMENTAL CHANGES

4. Deferred Compensation and Tax-Preferred Accounts

- ABLE Account contribution limitation increased (accounts for the benefit of the disabled)
- Distributions from 529 accounts can now be used at elementary and secondary schools, in addition to existing higher education institutions

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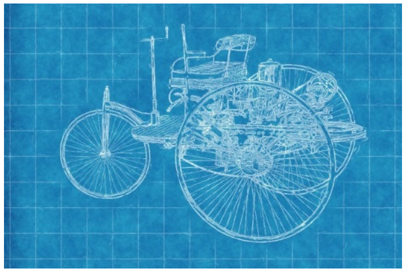
17 FUNDAMENTAL CHANGES

5. Ordinary Income / Capital Gains Treatment

- IRC §1061 Carried interest (profits interest) will receive long-term capital gain treatment if held for at least three years. If held less than three years, it will be taxed as short-term gain at ordinary rates.

- The following self-created property (intellectual property) items are no longer capital assets if held by taxpayer who created the property or has transferred basis:
  - Patents
  - Inventions
  - Models or designs
  - Secret formulas or processes



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17 FUNDAMENTAL CHANGES

6. Estate and Gift Tax Provisions

- IRC §2010(c)(3)(C) Doubles the gift tax exemption from $5 million to $10 million, indexed for inflation
  - Expected exemption in 2018 is $11.2 million, though the IRS may issue a revised inflation adjustment for the basic exclusion amount applicable for 2018 using chained CPI that results in a lower basic exclusion amount.
- As before, beneficiaries must continue to receive a “step-up” basis at the date of death for inherited assets.

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17 FUNDAMENTAL CHANGES

7. Disaster Relief Provisions

- For tax years 2016 and 2017 only
- Net disaster loss can increase standard deduction, thus no requirement to itemize or subject to AMT add-back
- Net disaster loss floor increased from $100 to $500
  - 10% AGI threshold no longer applies
- Qualified 2016 disaster distributions up to $100,000 are permitted from eligible retirement plans
  - Not subject to 10% early withdrawal penalty
- Includes any area in which a major disaster has been declared by the President

17 FUNDAMENTAL CHANGES

8. IRS Practice and Procedure

- Taxpayers have two years to contest wrongful levies
- Paid preparers are subject to a $500 penalty for failure to comply with due diligence requirements on taxpayers claiming “head of household”

17 FUNDAMENTAL CHANGES

9. Retirement Plan Provisions

- Recharacterization of Roth conversions no longer permitted

EXAMPLE

Frank may make a contribution for a year to a Roth IRA and, before the due date for his income tax return for that year, recharacterize it as a contribution to a traditional IRA. Frank may also still make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA, but the individual is precluded from later unwinding the conversion through a recharacterization.

17 FUNDAMENTAL CHANGES

9. Retirement Plan Provisions

- Recharacterization of Roth conversions no longer permitted
- Length of service awards for public safety volunteers increased from $3,000 to $6,000.
- An employee can exclude a transfer of a qualified plan loan offset amount from income as long as the transfer is made by the due date (including extensions) for filing the tax return for the tax year in which the amount is treated as distributed from a qualified employer plan

What makes a plan loan offset amount **"qualified"**?

It must be distributed solely by reason of either the termination of the qualified employer plan or a severance from employment.

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17 FUNDAMENTAL CHANGES

10. Corporate Taxes, Rates, etc.

- Corporate tax rate reduced to flat 21% rate, prior tax brackets and rates repealed
- Corporate AMT repealed
- Reduced dividends-received deduction

If the corporation owns at least 20% stock of another corporation, the dividends-received deduction is reduced from 80% to 65%.

All other dividends-received deductions are reduced to 50% from 70%.

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17 FUNDAMENTAL CHANGES

11. Expensing, Depreciation, and Capitalization

- IRC §179 deductions increased and eligibility expanded

Section 179 deduction increased to $1 million and phase-out limitation increased to $2.5 million

"Qualified real property" eligible for Section 179 has been expanded to include:

◦ Qualified improvement property (interior improvements to nonresidential real property)
◦ HVAC
◦ Roofs
◦ Fire protection, alarm, and security systems
◦ Lodging furnishings

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17 FUNDAMENTAL CHANGES

11. Expensing, Depreciation, and Capitalization

- IRC §168(k) Bonus depreciation deductions set and eligibility expanded

100% first year deduction on purchases made after 9/27/17 and before 1/1/23

Phase out after 2022:

80% for property placed in service in the 2023 calendar year
60% for property placed in service in the 2024 calendar year
40% for property placed in service in the 2025 calendar year
20% for property placed in service in the 2026 calendar year
0% (bonus expires) for property placed in service after December 31, 2026

Now allowed for new and used property

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17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- IRC §163(j) New limits on deduction of business interest

The deduction of business interest is limited for any tax year beginning after 2017 to the sum of the taxpayer's business interest income, floor plan financing, and 30% of adjusted taxable income.

The limitation generally applies to all taxpayers with average gross receipts greater than $25 million.

Any disallowed interest generally may be carried forward indefinitely.

In the case of a partnership or S corporation, the deduction limitation applies at the entity level, except that disallowed interest of the entity is allocated to each partner or shareholder as excess business interest.

17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- New limits on deduction of business interest

EXAMPLE 1

For 2018, Corporation X has $100,000 of adjusted taxable income, $2,000 of business interest income, and $12,000 of business interest expense. It has no floor plan financing interest.

X can deduct all $12,000 of its business interest expense, because that's less than the sum of its $2,000 of business interest income plus 30% of its adjusted taxable income (30% × $100,000 = $30,000).

EXAMPLE 2

In 2019, Corporation X has only $10,000 of adjusted taxable income and again has $2,000 of business interest income and $12,000 of business interest expense.

Here, X's deduction for business interest is limited to $5,000—its $2,000 of business interest income plus 30% of its adjusted taxable income (30% × $10,000 = $3,000). The $7,000 of disallowed interest can be carried forward indefinitely

17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- NOL deduction limited to 80% of taxable income before NOL deduction for losses after 2017
- Domestic Production Activities Deduction repealed
- Like-kind exchanges limited to real property only
- Entertainment expenses no longer deductible (previously limited to 50%)
- All business meals are subject to 50% disallowance
- 100% meals deduction “for convenience of employer” repealed
  - Limited to 50% until 12/31/25, then entirely disallowed

17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- Deduction for employee transportation fringe benefits (e.g., parking, mass transit, commuting) repealed
- Nondeductible penalties and fines updated to include payments in relation to violation of any law
- No deduction for amounts paid for sexual harassment
- Employee achievement awards are excluded from income up to $400
  - The definition of "tangible personal property," for purposes of what is a deductible as an employee achievement award is amended to exclude cash, cash equivalents, gift cards, gift coupons, and gift certificates

17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- Excessive employee compensation to covered employees is deductible up to $1 million
  - Applies to publically held corporations only
- All lobbying deductions are disallowed
  - Previously, an exception existed to allow deductions for <u>local</u> lobbying costs

17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- IRC §1400Z-2 Qualified Opportunity Zone – gain deferral allowed for qualified sales or exchanges in opportunity zones

A population census tract that is a low-income community may be designated as a qualified opportunity zone by a State.

A taxpayer may elect to exclude gain on the sale or exchange of any property to an unrelated party from gross income in the tax year of the sale or exchange if the gain is reinvested in a qualified opportunity zone within 180 days of the sale or exchange.

Qualified opportunity zone property includes:

- Stock
- Partnership interest
- Business property

The deferred gain is recognized on the earlier of the date on which the qualified opportunity zone investment is disposed of or December 31, 2026.

17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- Qualified Opportunity Zone – Proposed Regs Issued
  - Only capital gains are eligible for deferral
  - Eligible Taxpayers are those that can recognize capital gain
  - Eligible investments must be an equity interest, including preferred stock or partnership interest
  - Basis of land not considered for determination of substantially improved
  - Form 8949 filed in the taxable year the gain would have been recognized
  - Public hearing is scheduled for January 10, 2019

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17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- IRC §47 Rehabilitation credit limited

The 20% credit for qualified rehabilitation expenditures with respect to certified historic structures is now claimed ratably over a five-year period beginning in the tax year in which the rehabilitated building is placed in service.

The 10% credit for qualified rehabilitation expenditures with respect to non-historic structures first placed in service before 1936 is eliminated.

17 FUNDAMENTAL CHANGES

12. Business Deductions, Exclusions, and Credits

- IRC §45S(a)(1) New general business credit to employers for qualifying employees paid under FMLA

Eligible employers are entitled to claim a credit for paid family and medical leave equal to 12.5% of wages paid to qualifying employees during any period in which such employees are on leave under the Family and Medical Leave Act (FMLA) provided that the rate of payment is 50% of the wages normally paid to the employee.

The credit is part of the General Business Credit and only available for wages paid in tax years beginning after December 31, 2017, and before January 1, 2020.

17 FUNDAMENTAL CHANGES

13. Accounting Methods

- Accrual method
  - Taxpayers must recognize income no later than the tax year such income is taken into account on an "Applicable Financial Statement,"

First, amounts are generally included in income no later than when the amounts are included for financial accounting purposes.

Second, taxpayers can elect to defer including certain advance payments in income until the tax year after the tax year in which the payments were received, subject to limitations.

Instead of reporting advance payments when they are received, accrual-method taxpayers can use one of two deferral methods to postpone reporting the advance payments to a later time.

17 FUNDAMENTAL CHANGES

13. Accounting Methods

- Cash method
  - Available to most taxpayers under $25 million gross receipts test
  - Will not be required to apply the inventory to uniform capitalization (UNICAP) rules or to use the percentage of completion method for small construction contracts.

EXAMPLE

Widgets, Inc., a C corporation, wants to determine if it can use the cash method under the expanded gross receipts test for the 2018 tax year. For tax years 2015, 2016, and 2017, the corporation has gross receipts of $21 million, $26 million, and $25 million, respectively. Its average annual gross receipts for the three-tax-year period are $24 million.

The corporation meets the gross receipts test for 2018.

17 FUNDAMENTAL CHANGES

13. Accounting Methods

- Accrual method
  - Taxpayers must recognize income no later than the tax year such income is taken into account on an "Applicable Financial Statement,"
- Cash method
  - Available to most taxpayers under $25 million gross receipts test
  - Will not be required to apply the inventory or uniform capitalization (UNICAP) rules or to use the percentage of completion method for small construction contracts.
- Long-term contract accounting exemption increased from $10 million to $25 million.

17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

- IRC §199A Qualified Income Business Deduction

An individual taxpayer may deduct up to 20% of certain domestic qualified business income from a partnership, S corporation, or sole proprietorship for a tax year.

The deduction is generally limited to the greater of:

- 50% of W-2 wages paid by the business, or
- The sum of 25% of the W-2 wages paid plus 2.5% of the unadjusted basis of certain property the business uses to produce qualified business income.

This limit may be phased-in or eliminated if the taxpayer's taxable income meets certain threshold requirements.

This deduction is not to exceed 20% of individual taxable income

17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

- Qualified Income Business Deduction

EXAMPLE 1

Thomas operates a sole proprietorship that makes personalized protective covers for smartphones. The business buys a machine for $100,000 that can quickly produce the covers, and places the machine in service in 2020. In that year, the business has no employees.

50% of W-2 wages
($0 × 50% = $0)

<

25% of W-2 wages plus 2.5% of the unadjusted basis of the machine immediately after its acquisition
($0) ($100,000 × 0.025 = $2,500).

The W-2 wages/qualified property limit on the business's deductible amount for 2020 is $2,500

17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

- New deduction for pass-through income: one pass-through

EXAMPLE 2

	Partnership A	Partnership B	Partnership C
Gross Income	11,000,000	11,000,000	11,000,000
Wages Paid	(1,000,000)	(5,000,000)	-
Other Deductions	(5,000,000)	(1,000,000)	(6,000,000)
Taxable Income	5,000,000	5,000,000	5,000,000
Initial Tax Basis of Qualifying Property	800,000	2,000,000	30,000,000
20% of Taxable Income	1,000,000	**1,000,000**	1,000,000
50% of Wages Paid	**500,000**	2,500,000	-
25% of Wages plus 2.5% of Tangible Property	270,000	1,300,000	**750,000**
Pass Through Deduction Allowed	**500,000**	**1,000,000**	**750,000**

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17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

- New deduction for pass-through income: multiple pass-throughs

EXAMPLE 3

	Individual A	Individual B	Individual C
K-1 #1	500,000	500,000	500,000
K-1 #2	400,000	400,000	(400,000)
W-2 income	-	150,000	150,000
Adjusted Gross Income	900,000	1,050,000	250,000
Itemized Deductions	(50,000)	(50,000)	(50,000)
Taxable Income Before Pass Through Deduction	850,000	1,000,000	200,000
Pass through Deduction - K-1 #1	(100,000)	(100,000)	(100,000)
Pass through Deduction - K-1 #2	(80,000)	(80,000)	-
Pass through Deduction Cap - 20% of Taxable Income	(170,000)	(200,000)	(40,000)
Pass through Deduction	**(170,000)**	**(180,000)**	**(40,000)**
Taxable Income	680,000	820,000	160,000

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17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

Specified Service Trade or Business (SSTB)

Subject to taxable income Phase-In Rules

Taxable Income	SSTB 20% §199A Deduction
$315,000 Joint (157,500 Other Returns)	Qualifies
$315,000 - $415,000 Joint Returns (157,500 – 207,500 Other Returns)	Deduction reduced ratably
Over $415,000 Joint (207,500 Other Returns)	Disqualified

17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

Specified Service Trade or Business (SSTB)

- Statutory definition is "any trade or business activity involving the performance of services in the fields of **health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services**, or any trade or business where the **principal asset** of such trade or business is the **reputation or skill of one or more of its employees or owners**; any trade or business involving the **performance of services consisting of investing and investment management, trading or dealing in securities** (as defined in §475(c)(2)), **partnership interests, or commodities** (as defined in §475(e)(2)).
- Expressly excludes the performance of architectural or engineering services
- No aggregating Income
- De Minimis SSTB Gross Receipts Safe Harbor (will not classify as SSTB)
  - Gross receipts of $25 million or less & less than 10% overall gross receipts generated by an SSTB
  - Gross receipts over $25 million & less than 5% overall gross receipts generated by an SSTB

17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

- Repeal of partnership technical termination
- Look-through rule applied to gain on sale of partnership interest by a foreign person
- "Substantial built-in loss" modifications

The Code Sec. 743 definition of a "substantial built-in loss" is modified so that a substantial built-in loss also exists *if the transferee would be allocated* a net loss in excess of $250,000 upon a hypothetical disposition at fair market value by the partnership of all partnership assets immediately after the transfer of the partnership interest.

In other words, even if the partnership itself does not have an overall built-in loss, depending on allocations of gain under the partnership agreement, a basis adjustment may be mandated with respect to a transferee.

17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

Substantial Built-In Loss Modifications

EXAMPLE

ACME Partnership has not made a Code Sec. 754 election. The partnership has two assets, X and Y. Asset X has a built-in gain of $1 million; Asset Y has a built-in loss of $900,000. Under the partnership agreement, any gain on the sale of Asset X is specially allocated to Partner A. Partners A, B and C share equally in all other partnership items, including the built-in loss in Asset Y.

	ACME Partnership	Partner A	Partner B	Partner C
Asset X	built-in gain **$1 million**	built-in gain **$1 million**	-	-
Asset Y	built-in loss **$900,000**	built-in loss **$300,000**	built-in loss **$300,000**	built-in loss **$300,000**
Net Built-In Loss/Gain	built-in gain **$100,000**	built-in gain **$700,000**	built-in loss **$300,000**	built-in loss **$300,000**

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17 FUNDAMENTAL CHANGES

14. Pass-Through Entities

- Partner's basis and allowable loss must account for partner's distributive share of partnership charitable contributions and foreign taxes paid
  - Supersedes a private letter ruling and closes an apparent loophole that did not reduce a partner's basis by such a deduction
- New rules for §481(a) adjustments for eligible S corporations revoking their S elections during the two-year period beginning December 22, 2017

17 FUNDAMENTAL CHANGES

15. Tax-Exempt Organizations and Bonds

- Excise tax on excessive executive compensation over $1 million for tax-exempt organizations
- Excise tax of 1.4% based on investment private income of colleges and universities
- Unrelated business taxable income must be separately computed for each trade or business activity such that losses from one activity cannot offset income from another entity
- Advance refunding bonds repealed
- Tax credit bonds and direct pay bonds repealed

17 FUNDAMENTAL CHANGES

16. Electing Small Business Trust (ESBT) Provisions

- Nonresident alien individuals are now permitted to be beneficiaries of ESBTs
- Charitable contribution deductions of an ESBT are determined based on rules applicable to individuals rather than trusts
  - The percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT-holding S corporation stock

17 FUNDAMENTAL CHANGES

17. Foreign and International Tax Provisions

- Participation exemption system for foreign income
- Passive and mobile income rules
- Other Subpart F modifications
- Base erosion prevention
- Foreign tax credit modifications
- Other international reforms

QUESTIONS?